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20, Indonesia, and the Crisis

Susilo Bambang Yudhoyono

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Ali Alatas: Indonesia's Top Diplomat

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Ed Masters

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The Logo



To better represent the underlying ideas that gave birth to CSIS in 1971, the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, was designed by Indonesia's renowned sculptor G. Sidharta and comprises a disc with an engraving of the globe, which serves as a backdrop to a youth with an open book on a cloth draped across his lap, his left hand pointing into the book, and his right raised upwards. All these elements combine to project the Centre's nature as an institution, where people think, learn and share their knowledge. Mankind is their concern and the world their horizon. The undressed torso symbolises open-mindedness and the absence of prejudice in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "Nalar Ajar Terus Budi", in the Javanese language, conveys the Centre's belief that "to think and to share knowledge are the natural consequences of an enlightened mind." It is a surya sengkala that is chandra sengkala - a Javanese traditional way to symbolise a memorable year in the lunar calendar, adapted to the solar calendar system. It uses words that express the perceived meaning of the commemorated year while marking the year at the same time, with each word having a numerical value. Thus, the inscription, in reverse order, represents the year CSIS was established: 1971.

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G20, Indonesia, and the Crisis

An Attempt to Cope with the Global Financial Crisis

Susilo Bambang Yudhoyono

3-10

Indonesia must focus on the priorities to restore confidence and stability of the global financial system. In the medium and long run, Indonesia needs to fix the international financial architecture to make it stable, less fragile and functioning better.

Indonesia and the G20 *Sudjadnan Parnohadiningrat*

11-18

Indonesia's participation in each and every international forum should be based on a pragmatic approach, namely one with Indonesia's priorities, national economic and security interests on top of other concerns. Indonesia is in a position to contribute to the world's policy agenda in a G20 that is no longer an exclusively economic and financial forum.

Global Economic Integration *Andrew Elek*

19-31

The G20 process creates new opportunities for international cooperation. The new forum contains a more diverse and representative group than the G7 and the inclusion of emerging economic giants gives it additional legitimacy. However, whether the G20 can become an effective ongoing forum and whether it will attempt to promote global economic integration remain to be seen.

The Global Economic Crisis and Its Impact

on the Housing Sector in East Asia *Hadi Soesastro*

32-60

East Asia is again in the midst of a financial crisis after having overcome one that happened only a decade ago. The housing sector in the region may be the sector that could be immediately affected by the economic downturn, globally and regionally.

Ali Alatas: Indonesia's Top Diplomat

*Jusuf Wanandi, Wiryono Sastrohandoyo, Sabam Siagian,
Nugroho Wisnumurti, Ed Masters*

61-80

On 11 September 2008, Ali Alatas passed away in Singapore of a heart attack. Ali Alatas was one of Indonesia's most widely respected ministers.

A charismatic man, he was respected internationally for his experience and diplomatic skills. The Indonesian Quarterly has compiled five articles by his dear friends. This serves as a tribute to a person with whom we had a chance to work closely and whom we greatly admire.

Indonesia-Japan Economic Partnership

IJEPA: The Implementation Road Ahead

Bob Widyahartono

81-95

A focus on the future of the implementation of Indonesia-Japan Economic Partnership Agreement in the years ahead would be incomplete if limited solely to the manufacturing industry. Other important areas are: financial networks, and human resources development in related industrial network. To be successful players, Indonesian companies must develop true capacity.

Review of Developments

Pre-Election Political Dynamics

Arief Priyadi

96-102

Growth Tumble in the Midst of Global Shrinking

Fajar B. Hirawan & Widdi Mugijayani

103-124

AN ATTEMPT TO COPE WITH THE GLOBAL FINANCIAL CRISIS

Susilo Bambang Yudhoyono

We all agreed that we need to act fast, and in a concerted and coordinated manner. We must also focus on the priorities to restore confidence and stability of the global financial system. Equally important are our joint efforts to prevent further deterioration of growth. In the medium and long run, we need to fix the international financial architecture to make it stable, less fragile and functioning better. Our people back home have high expectations that we will be able to deliver all of these. Let me make the following points and suggestions.

I believe that our measures should involve three steps: short-term, medium-term, and longer-term actions. We have to stop this bleeding, and provide the much needed new blood so that we can all function normally again.

Short-term actions should be simple and workable. And we need very close international coordination to put the measures to restore confidence into place.

Mid-term actions are necessary to revitalise economic growth and protecting the most vulnerable.

Longer-term actions are measures to solve the root cause of the problem in the current global system, and to prevent the same from happening in the future.

Susilo Bambang Yudhoyono is the President of the Republic of Indonesia. This is an edited version on his Statement at the G20 Summit in Washington, D.C. on 15 November 2008.

Our action must be pursued simultaneously at the national, regional and global level. At the national level, like all other countries, Indonesia has quickly responded to the crisis, among others, by ensuring the availability of liquidity in the system, providing guarantees to maintain confidence in the banking sector. We also took necessary steps to unlock the credit crunch, including for trade financing, which is already affecting trade flows. Through fiscal and budgetary measures, we also provide social safety net to mitigate the impact of the financial crisis to the poorest segments of society. Learning from the crisis a decade ago where we lacked confidence, trust and coordination, we have also made sure that our response, both fiscal and monetary, brings together all the stakeholders, including the Central Bank and business.

At the regional level, ASEAN and ASEAN Plus Three countries must better synchronise their policies, including the Chiang Mai Initiative (CMI), which is a form of self-help reserve policy. This is necessary to ensure the continued flow of trade and investment in the region.

Through this summit and the next ones, we must be able to undertake coordinated and concerted efforts. We urge the international financial institutions to stand ready their balance sheets to pool and mobilise resources in a credible amount at the global level.

At the global level, we must do all we can to mitigate the damaging effects of this crisis to emerging market economies and fewer developing countries. Developed countries have better resources to undertake counter-cyclical measures to restore global growth, and this will very much help sustain their trade and investment in developing countries. The developing countries must also be able to carry out effective fiscal spending in the critical areas of infrastructure development, job creation, poverty reduction and other development goals.

Therefore, we urge the international community, especially advanced economies, reserve-rich countries and international financial institutions, to provide financial access and instruments with flexible mechanism to help them withstand the severe liquidity problem.

That is why we need to form a kind of "Global Expenditure Support Fund" to support budget financing, on top of regular development assistance (see Annex, *editor*). This Fund should be made available for countries that are most vulnerable and most in need. It should also be given to countries that have a strong track record in adopting sound policies and fiscal sustainability. This way, these countries can sustain growth, while cushioning the poor from the devastation of the crisis, and reach their MDG goals.

We also should encourage multilateral financial institutions to provide liquidity, credit and trade financing facility so that economic activities across the border can be maintained.

After prioritising our fire-fighting mission, our next steps should address the failures of the global financial system by providing disciplined risk management and accurate information and disclosure. We urge the international financial institutions to adopt the international best practice in risk management, improving accountability, transparency and surveillance.

In pursuing these objectives, we should not waste our time on questioning whether we need more or less regulations. Indeed, what we desperately need are better and more effective regulations.

However, these new and enhanced international financial norms and regulations will certainly burden the emerging markets and developing countries. They will need transitional time to improve their capacity to adopt and to implement those norms. To this end, the international community should therefore provide technical assistance to these countries.

The developing countries cannot but feel that they are being punished for something that they did not cause. Ten years ago, when we faced the monetary crisis, we were forced to undertake stern measures to overcome the situation. What we have realized today is that the international financial architecture too needs to be reformed.

What we need today is efficient, properly regulated financial system. To be effective, existing multilateral institutions should reflect the new global economic constellation with the increasing role of the emerging markets, through their greater voice and representation. In

the longer-term, if we have to think outside the box, we may think about far reaching global governance, which provides a way to reduce unnecessary speculation and dangerous bubble economy to avoid destructive risk-taking in the financial market.

It should be underlined again that the world should take immediate actions to respond to this crisis. It should be emphasised once again that urgent action is needed. The actions to be taken must therefore be credible, furnished with strong will to implement it.

It should also be realised that the cost of inaction would lead to further disruption to the global financial system, endangering everything that has been achieved during the last several decades. The longer we allow the crisis to unfold, more innocent victims will fall due to market instability. In particular, many small-open-emerging markets would suffer most from the crisis, even though they have undertaken reforms, conducted right policies and built sound institutions. We should not allow this to happen because emerging markets play a very important role in solving this crisis.

To conclude, upon issuing the declaration of this meeting, we as leaders should be able to put this declaration into action. Therefore, we should task our ministers of finance to come up with a list of actions and a clear timetable for implementation, which consistently reflects our common responsibilities and differentiated capacities.

One final point: in revitalising global economic growth, coordination of fiscal expansion and keeping markets open become a key priority. Concluding the Doha Development Agenda (DDA) round of negotiations with a balanced outcome and ensuring open regionalism in the various regional agreements, will provide collective confidence to keep markets open and ensure fair and equitable trade.

One thing to be underlined here is that Indonesia, with our limited resources, will do all we can to ensure that our achievements to reduce poverty, unemployment and debt to GDP ratio, which is now down to 32% will not go to waste. Indeed, none of our development agenda and achievements can be sustained without regional and global cooperation.

ANNEX

(Taken from a Background Paper prepared for Indonesia's Participation in the G-20 Summit, Washington D.C, 15 November 2008)

PROPOSAL FOR A GLOBAL EXPENDITURE SUPPORT FUND

Emerging economies have been hit particularly hard by the fallout from the financial crisis. The indiscriminate re-pricing of risk has happened despite efforts by many emerging countries to implement reforms, undertake sound economic policies and to strengthen their institutional structures. In particular, the shortage of liquidity in international money markets has made it increasingly difficult for even these well managed emerging markets to access external financing.

The freezing of liquidity could create severe problems for emerging markets in meeting the required financing of their budget, in addition to the financing of the balance of payment. This will in turn gravely endanger the achievement of development, or even worsen reverse achievements to date.

In facing the impact of the crisis it will be crucial for such countries to have enough fiscal room for well-targeted fiscal stimulus and social safety net programmes to provide relief to the poor and ensure creation of jobs. Developing economies understand that they cannot lose sight of their development focus. Developing economies need to honour commitments to upgrading their infrastructure, empowering rural communities, providing better access to health services and education facilities. Stabilising food prices is also essential. As a developing economy, Indonesia must remain pro-growth, pro-poor and pro-job creation.

It needs to be recognised that the crisis has directly affected the ability of many economies to secure cost-effective financing. A failure to access affordable financing would impede developing economies expansionary fiscal policies, which in turn could affect their efforts to best counter recession and protect the poor. Under the worst case scenario the crisis has the potential to send tens of millions into poverty and would severely impede efforts to achieve the Millennium Development Goals. In case severe market disruptions have limited

access to necessary financing for counter cyclical fiscal policies, multilateral development banks must ensure arrangements are in place, as needed by those countries with good track record and sound policies.

In this context, Indonesia submits a proposal for the establishment of a Global Expenditure Support Fund (GESF) in order for developing countries to maintain reasonable levels of economic growth and sustain development. This need should not be overlooked. Emerging economies, particularly in Asia, have been asked to maintain their relatively high rates of economic growth so as to be able to act as an engine of growth for the world economy. The GESF could facilitate this.

The main function of the GESF is to support budget financing—as well as project financing, on top of regular development assistance—to be used specifically for the implementation of counter cyclical measures aimed at ensuring sustained economic growth in the face of external shocks. In doing so, it also aims at helping to sustain global economic growth.

Such a fund would assist countries that traditionally rely on market sources for their financing requirements but are facing difficulties due to the breakdown and disruption of financial markets. It will also reduce crowding out effect of governments in competing with private sector needs for financing in an already very tight liquidity situation. Accessing the fund would reduce sovereign exposure to volatile market risks and allow countries with already good track records to continue to build capacity, advance good policy and to continue to pursue their development agenda.

Countries with a good track record on fiscal sustainability, demonstrating a commitment to a development agenda, prudent debt management, and sound capital markets would be eligible to access the funds as a transitional arrangement over the next two to three years.

Since funding under the GESF is to be used at the time of crisis, its disbursement should be quick with minimal conditionality. The main justification for establishing the GESF is the recognition that the cost of inaction on this front will be high, while its modest size—relative to the

potential huge amounts needed for balance-of-payments financing—could go a long way in sustaining global economic growth.

On the governance aspect, decision making in the GESF should reflect the new realities in the global economic constellation, specifically the increased role of new emerging large economies. The GESF need not be established as a totally new institution. It could utilise the facilities of the World Bank Group and other ifis with the provision that it is managed under a new governance structure. The modality, financing, management, governance structure and general policies should be worked out by Finance Ministers within the next 100 days.

To sum up, the GESF is a pooling of funds aimed at budget support for eligible countries with the following elements:

- Top up of amounts of current support already pledged;
- It could take the form of a newly established fund or a trust fund managed by an existing multilateral institution;
- The funds should only be used for budget support spending for infrastructure and programmes to support MDG goals (as well as ensuring lack of access to trade financing does not impede trade flows);
- It has a lifecycle of minimum 3 years with the maximum period facility provided for 10 years;
- It is a temporary replacement for market shutdown;
- The support will be provided only for “eligible” Middle Income Countries (mics);
- The support will be given in the form of direct loan or promissory notes/government bonds issued by mics to the developed countries guaranteed by multilateral institutions;
- “Eligible” countries are those that meet the following criteria:
 - = Rely on the market to finance substantial amounts of its budget;
 - = Experience difficulties in getting external financing despite their sound

Fiscal position, as reflected in the increase of cost of fund;

- = Good track record of fiscal discipline over the last 3 years;
- = Consistently undertook reforms of governance and increased transparency;
- = Able to design and implement a "policy matrix" of measures to enhance Development outcomes;
- = Experience a significant reduction of economic growth (e.g., experiencing a Deviation by more than 30% of the average growth in three years);
- = Still has significant number of poor people (e.g. More than 20% of the Population is below the poverty line.

INDONESIA AND THE G20: PARTICIPATING IN AN INCLUSIVE GLOBAL GOVERNANCE FRAMEWORK FOR THE 21ST CENTURY CHALLENGES

Sudjadnan Parnohadiningrat

As the world economy is reeling further into a deep and painful economic slowdown, of the magnitude we have not seen since the Great Depression of the 1930s, world leaders have begun to set international coordination and collaboration as critical priority. Existing multilateral frameworks are available for this purpose. But their structure, membership, and culture can hinder a swift decision making process needed to respond to the critical challenges being faced by the international community today. In this context one may ask a question whether the G20 construction is a viable option to choose as the inclusive global framework to respond to the present critical challenges of global financial and economic crisis? Is that construction the one that the World Bank President Robert Zoellick and UN General Assembly have called for?"

The experience from the way economic crises were responded over the decades (the Peso crisis of 1995, the Asian financial crisis of 1997, Russia's default of 1998, the tech bust of 2001) told the world that a swift and sharply-targeted response by the respective national financial authority of the affected country by enacting robust and appropriate set of national policies was critical. Coupled with international response and multilateral financial institutions' help,

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those national undertakings did assist the affected countries to weather the worst of the storm to their economy.

This time around, the nature and plethora of the crisis are different. It is widely observed that it could lead to a one-in-a-century global depression. The widespread default dragged prominent Wall Street hallmarks into bankruptcy. The complexity of financial instruments and the globalised spread of their investment and businesses have brought the global financial system to the brink of collapse, resulting in a crisis of confidence at a global scale.

The current crisis started in the United States, the wealthiest country in the world, in New York City where the financial capital of the globe is located. The severity level of the crisis is shown by figures, such as unemployment, where it increased by 2.7 million since the recession began in December 2007; and the contraction of the US economy, which in the third quarter of 2008 decreased at an annual rate of 0.5%. As Thomas Friedman argued, if the crisis were to start in another country, the Americans can insulate themselves, but when it starts in the United States, no one country is insulated. Unlike previous challenges, the speed, scope and scale of the contagion took an unprecedented rate and magnitude.

Here an internationally coordinated and coherent approach to correct the mistakes, resolve the crisis, and establish preventive measures to a similar future crisis is imperative. In 2005, Paul Martin, the former prime minister of Canada, wrote in *Foreign Affairs* on the need for the right countries to sit together conducting frank and candid talk to assess each other countries' situation including their respective policies, measures and what they imply. These countries should adopt a set of common principles for sound domestic economic management, broadening the Washington Consensus to include sustainable development agenda and promote monetary and financial stability. One may ask another question "... is this not re-inventing the wheel? After all there are many international bodies that facilitate this kind of get-together."

Well, not so. The United Nations for instance, through its Economic and Social Council (ECOSOC) and the International Conference on

Financing for Development certainly can play a role in the resolution of the global crisis. In spite of this, its enormous membership of 192 countries makes it cumbersome and time consuming to take a swift and firm decision. What about the G7 or APEC? These fora are surely nimble and can agree on a set of decisions fairly quickly. However, they are too exclusive. None of the emerging economies of Africa, Asia, and Latin America are members of G7. In the case of APEC, India, and large countries of Africa and Latin America are not represented.

The International Monetary Fund (IMF), however flawed a number of its prescription were, relieved balance of payments pressures faced by countries in the midst of crises. But the Fund and its twin sister, the World Bank, are facing an internal crisis of their own: how to restructure their respective organisation to better reflect the weight and representation of member countries. This will take time to resolve. Meanwhile, time—especially in these current circumstances—is a precious commodity.

The G20 process seems to be filling the gap. In its purposefully narrow scope of economy and finance, the G20 Ministerial has been diligently functioning since its inception in 1999. The forum is recognised as the venue for informal discussions, where its open and constructive atmosphere encourage representatives to talk on key topics of common concern pertinent to global economic stability. However, if the existing process proves to be more effective, a weightier Leaders-20 process is needed.

A more encompassing and permanent G20 forum would be suitable to exchange views, or even adopt a set of measures on the issues of the day. The political will is there, and the forum is also available with membership representing the advanced and emerging economies of the world alike. Both countries of the north and south, and each continent except for Antarctica and Arctic are represented. The potential of this grouping rests in the real powers the members wield. They are major and medium sized world economies and have strong influence in all the major global issues from economic interdependence and globalisation to security threats, such as

terrorism and non-proliferation of weapons of mass destruction, as well as from environment and energy issues to global public health. With its economic and political weight, when focused and common grounds are reached, it can give strong impetus to resolution of a host of issues from deadlocked trade negotiations and a new post-Kyoto climate change regime to traditional and non-traditional security threats.

In the G20 Summit of 15 November 2008, the Leaders of advanced economies stood at an equal footing with their emerging nations' counterparts and talked about the economy and politics in an open and frank manner. They put off discussions of the future shape of the world's financial system architecture, which was first established in Bretton Woods towards the end of World War II in 1944. Nevertheless, the candid discussions that had yielded clear instructions to their relevant ministers and officials have put flesh in the action plan that will be immediately implemented. National and international measures to be undertaken will expectedly restore global confidence and generate further the reforms in the world's financial systems.

This was not just a communiqué. This was an effort spearheaded by member countries representing 85% of the \$60 trillion global economy, 80% of global trade, and 67% of the world's population. For instance, the emerging markets of Brazil, China, India, Indonesia, Mexico and Russia have a combined population of almost 3.2 billion people and a collective GDP of US\$ 8.4 trillion, or about 14% of the world's GDP. China, India, and Indonesia enjoyed a robust economic expansion over the years, and although the crisis is expected to put a brake on this, China is forecasted to maintain still a 7.5% growth, India 6.7%, Indonesia between 4.5 – 5%, Brazil, Russia and Mexico at a reasonable pace. These projected emerging nations' growths will in part mitigate the global economic downturn.

As we may recall, the United States has been instrumental in leading and pulling together both the Major Economies Meeting on Climate Change and the G20 Economic Summit. These informal summits were incidental and organised in response to a certain crisis at a certain period of time. It is only through a leadership with

an inclusive process, that the United States could make the forum relevant, while satisfying and reconciling various members' national interests.

Yet going forward, another key factor in the equation, of course, would be President Obama and what priority his administration will put on the G20 process. In his campaign promises outlined in March 2008, Obama called for an overhaul of the financial system and to establish a 21st-century regulatory system. Obama appealed for stronger government oversight and supervision over financial institutions including for liquidity and capital requirements. Furthermore, he underlined the need for general reform of regulated financial institutions requirements including actions to: (i) strengthen capital requirements particularly for complex financial instruments; (ii) develop and rigorously manage liquidity risks; (iii) investigate ratings agencies and their potential conflicts of interests; and (iv) provide greater transparency requirements. Obama stated that financial institutions around the world are also subjected to the same rules to make the system more stable.

Judging from what he has stated, President Obama seemed to be more aligned with European leaders on the belief that the current crisis might have been lessened or even avoided had governments tightened regulations and supervision for all major financial players. President Obama will attend the April 2009 Summit in London, showing his commitment to the process, particularly on the immediate issue of the global financial crisis.

For Indonesia, careful analysis is needed to understand how best to capitalise on the G20 membership in order to advance her interests, especially as it possibly moves to replace the G8 as a global steering group on high profile and high priority issues.

First, the policy positions preferred by the developing countries have not made significant progress in the group. Although developing countries especially Indonesia are more active and assertive; and have provided original contributions to the global policy agenda, the benefits of the initiatives have been fairly small. According to a study by Leonardo Martinez-Diaz of the Brookings Institution, in

the eight years of G20 Finance Ministers and Central Bank Governors meetings, the forum has mainly served as a vehicle for mobilising support for G7 policies. Hence, Indonesia should be able at any point to review its approach, especially when the topics of the forum broaden, in order to reflect an inclusive domestic process involving relevant stakeholders.

Second, Indonesia stands in a uniquely distinct position as the only Association of Southeast Asian Nations (ASEAN) country seating at the same table as the countries of G20. Indonesia is among those states that are major and middle economic and financial powers, major energy exporters and importers, major players on global as well as regional security arena, and the major polluters of the world. Indonesia is being positioned in such a way that enables it to engage ASEAN members in the G20 process. In this respect, Indonesia can provide an indirect venue for ASEAN members to voice their concerns on the issues at stake in the G20. A similar approach can also be employed in other multilateral fora.

The recently published report entitled "US National Intelligence Council (NIC): Global Trends 2025" suggested that the international circumstances will shift the global power configuration away from the United States and advanced countries of the European Union and eastern Europe toward Asia and other emerging nations. Although we will not know the outcome for sure until we are further in the future, it is clear that countries like Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, and Turkey are increasingly becoming significant players in the global economic and political game. Emerging economies are here to stay, and looking at their growth trajectory, their economic share of the world's output will only grow in parallel with their international political clout. Engaging this group in a more inclusive body and away from the old traditional ways of business dealings is the only sensible approach in order for international agreements to stick and have meaning.

Some analysts construe Indonesia's membership in this grouping as a reflection of her growing influence in the world stage. As a consequence, Indonesia has to position itself as a responsible

participant, bringing not only her own but also many others' interests. In order to significantly contribute in shaping the global policy agenda and reaping the benefits of G20 initiatives, nevertheless, Indonesia has praiseworthy capitalised on a number of short-term but critically important gains for charting a strategic framework of engagement in the G20.

Indonesia, under the leadership of President Susilo Bambang Yudhoyono, had recently shown economic and financial trajectory that is already on the right track. Strenuous structural reform to improve the investment climate, strengthen economic fundamental, financial sector, regulatory framework and legal system has been conducted. Various other measures have been taken, such as strengthening the food base industry, expanding and improving the quality of health services and education. An expanding middle-class is also taking place although at a slower rate. These steps and circumstances would ensure that Indonesia could fit itself in the dynamic of G20 functioning. In the medium term it can take the most advantage of the 2025 demographic bonus when youth bulges becomes worker bulges as observed in the National Intelligence Council report published recently.

What needs to be critically sustained is Indonesia's participation in each and every international forum that should be based on a pragmatic approach, namely one with Indonesia's priorities, national economic and security interests on top of other concerns. In a grouping such as the G20, alliances will be dynamic, established and re-established constantly on issues of common interests. When on certain issues Indonesia needs to align or re-align with countries both within and beyond the grouping, such as regionally, then and only then will Indonesia decide whether it can afford to shift alignment in order to pursue the foremost priority of its interests. Foreign policy making and implementing process need to be well orchestrated, placing the responsible institution in its function in accordance with the prevailing laws in order to assure coordinating process runs effectively.

And finally, what Indonesia has achieved today should be nurtured while anticipating the opening-up of the forum to include the planet's major issues discussed in a more regular gathering at

multiple levels of decision makers. If this happens, Indonesia is in a position to participate and contribute to the world's policy agenda in a G20 that is no longer seen as an exclusively economic and financial forum but one that has far reaching impacts across major issues.

It would be interesting to observe this development and if all else remain equal, the G20 of the future can turn out to be the globe's premier forum, and could well influence other regional processes, such as the East Asia Summit (EAS), Asia Pacific Economic Cooperation (APEC), and ASEAN. And if it is going to be the case, then we will continue to participate constructively in the building of a new world machinery to deal with global issues of today and the future.

GLOBAL ECONOMIC INTEGRATION: AN OPPORTUNITY FOR THE G20

Andrew Elek

THE CHALLENGE¹

The emergence of the G20 process creates new opportunities for international cooperation. The new forum contains a much more diverse and representative group than the G7 and the inclusion of emerging economic giants gives it additional legitimacy. The G20 is potentially highly influential: if they can agree on matters of substance, other governments will be likely to follow their initiatives. Its members can reinvigorate existing institutions or create new processes; for example, the G20 has already proved able to reach the high-level political consensus needed to insist on a reform of the governance of the IMF.

The communiqué of the initial meeting indicates that the G20 will be an ongoing process which oversees the implementation of substantive work programs, covering a potentially broad agenda including energy security; climate change, food security, the rule of law, and the fight against terrorism, poverty and disease.²

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¹ This paper is a revised version of a post on the East Asia Forum website, available at http://www.eastasiaforum.org/wp-content/uploads/2009/01/elek_global_ec_integration_jan_15.pdf

² Paragraph 15 of the summit communiqué, which is available at <http://www.theaustralian.news.com.au/story/0,25197,24659778-601,00.html>

The productive engagement of more economies in the international economy is essential for dealing with several of these matters. Therefore the G20 will need to find ways to promote global economic integration.

Global economic integration will need to be complemented by rebuilding foundations of a global financial system, agreeing on how to share the burden of adjusting to a sustainable level of GHGs in the atmosphere in an equitable way, and the need to cope with potential scarcity of some natural resources.

The growth of China, India (and hopefully other economic giants including Indonesia) has huge implications for resolving these issues. Accommodating their growth will require vast structural adjustment which cannot be expected to take place in less than a global economy. Accordingly, the G20 should be interested in preventing a potential fragmentation of the WTO-based international trading system into competing trading blocs.

It may prove possible for some, or all, of the G20 economies to implement cooperative arrangements to reduce costs and risks of international economic transactions among them, or among some of them. These could set examples which can lead to wider arrangements among all interested economies.

Cooperation to promote mutually beneficial economic integration will need to look well beyond support for a general concept of 'free trade'. It will need to reflect the fundamental changes in the nature of international commerce since the GATT was set up 60 years ago with its focus on traditional border barriers to trade in goods.³

It will also be necessary to complement the work of the WTO with other forms of global economic co-operation, which need not all rely on negotiations.

Due to current political perceptions, to get rid of remaining border barriers needs negotiations. Fortunately, other issues are

³ An excellent overview of the changing nature of international economic transactions can be found in David L Hummels, "Introductory Essay: The debate over globalization," from *Focus: Globalization*, (New York, NY: National Council on Economic Education), 3. Available at: http://www.mgmt.purdue.edu/faculty/hummelsd/econ370/handouts/intro_globalization.pdf

not so politically sensitive. Once attention moves to other costs and risks of international commerce, such as administrative and logistic problems, the nature of cooperation becomes quite different. On such important practical matters, the constraints on collective or coordinated arrangements to facilitate market-driven economic integration are not disagreements about what should be done, but the capacity to design and adopt effective cooperative arrangements.

To create an integrated global economy, low border barriers to trade and investment need to be complemented by an international environment of transparency, best practice, and consistency of regulations, including competition policy, regulations on government procurement; mutual recognition of standards and qualifications; appropriate protection of intellectual property rights; efficient communications, including e-commerce; and best practice logistics.

Some G20 economies are well ahead of others in these terms. Others need to acquire the capacity to do so. To a large extent, promoting economic integration among diverse economies involves helping those that want to adapt current best practice by sharing information, experience, expertise and technology.

In other words, negotiations to impose limits on market-distorting or trade-impeding policies will need to be accompanied by a collective effort to boost the institutional and technical capacity to move towards a genuinely integrated global economy.⁴

RESPONDING TO CHANGE

The GATT/WTO system has been a huge success. It has created a rules-based global trading order where most products do not face significant traditional border barriers such as tariffs and quantitative restriction; allowing a steadily growing number of economies to trade their way out of poverty.

But it is no longer efficient to rely solely on an institution which was created to deal with international trade dominated by commodities

⁴ See Andrew Elek and Hadi Soesastro, "ECOTECH at the heart of APEC," in I. Yamazawa, (ed.) *APEC: Its Challenges and Tasks in the 21st Century*, (New York: Routledge, 2000)

and finished manufactures. These days, international commerce is an intertwined flow of goods and services accompanied by international movement of capital (including direct foreign investment), people and information.

Shallow integration, which deals with traditional restrictions on market access, needs to be complemented by promoting deep economic integration including by:

- reducing uncertainty about future market access: for example anti-dumping actions or other arbitrary or discriminatory measures to deal with trade tensions.
- reducing physical and administrative bottlenecks, such as shortfalls in infrastructure, ranging from harbours to telecommunications.
- harmonising domestic legislation and rules, such as those relating to competition policy or product and process standards.⁵

The Doha Round may be concluded in the future. But that will leave many more issues to resolve. It is no longer possible to expect all dimensions of economic integration be dealt with by WTO Rounds.

On one hand, the WTO negotiating agenda is already too wide; reaching agreements on single undertaking is taking far too long. On the other hand, agenda is also too narrow; no longer able to cope with all the new dimensions of international economic transactions and the impediments to them. These shortcomings are accelerating the growing reliance on Preferential Trading Arrangements (PTAs). Their proliferation will persist after the end of the Doha Round.

PTAs are proving attractive since they can address some issues of both deep and shallow integration at the same time. With careful choice of partners and a cynical interpretation of WTO disciplines on discriminatory trading arrangements, PTAs can be negotiated while largely avoiding politically difficult decisions on liberalising trade in sensitive products.

⁵ The distinction between shallow and deep integration is discussed in Robert Z Lawrence, *Regionalism, Multilateralism and Deeper Integration* (Washington, DC: Brookings Institution Press, 1996).

Compared to lengthy WTO negotiating rounds, it is proving much easier and faster to create trading arrangements among self-selecting economies to lock in low rates of protection for products which are no longer (or not yet) politically sensitive, and begin to deal with new issues, such as regulatory impediments to international commerce. However, PTAs can only promote deep integration with trading partners which do not threaten deeply entrenched producer interests.⁶

PTAs rely on discriminatory, product-specific rules of origin to avoid indirect competition to sensitive products, which run counter to market-driven globalisation. These impede opportunities for fine specialisation along lines of comparative advantage to take advantage of falling costs of transport and communications. There is growing awareness that the emergence of a network of overlapping PTAs, relying on trade-diverting rules of origin run counter to the reality of market-driven globalisation.

Concern about the emergence of potentially thousands of PTAs among pairs, or small groups of economies is leading to attempts to link them. However, it is hard to expand the membership of PTAs which have been tailor-made to avoid hard political decisions.

There is certainly no realistic prospect of a PTA which could link all G20 economies. G20 leaders will be well aware that negotiations attempting to create a PTA among their economies would need to deal with those same difficult issues which have slowed WTO negotiations. Negotiations to create a G20-wide PTA could not be completed in any meaningful timeframe. Moreover, any eventual outcome could only lead to a lowest common denominator result on liberalising trade, while delaying any alternative means of addressing new issues among the 20 economies.

⁶ Economies which insist on heavy protection of some products can negotiate PTAs only with economies which do not produce them, or with economies which are willing to exempt them from the agreements. For example, Japan can negotiate a PTA with economies like Singapore, which does not produce rice for export, but can only negotiate an agreement with Australia if the latter is willing to exempt rice from the coverage of the agreement.

Accordingly, there is some hope that the G20 will not be tempted towards a simplistic PTA approach which is focused on shallow integration and discriminates against all the smaller economies of the world. If G20 leaders can reject the PTA option, they can promote many other practical dimensions of economic integration among those of its members who were interested in preserving a global economy.

Some of potential areas of cooperation could be issues which are: (a) currently being dealt with in the context of PTAs; (b) on the WTO agenda, but could be taken further among a smaller group of governments; and, (c) of growing importance to international commerce, but not yet on the agenda of the WTO or of PTAs.

This article suggests that such cooperation can be possible, by taking care to design an appropriate approach to promoting potentially world-wide economic integration. That approach can, and will need to, learn from the experience of ongoing experiments, to promote integration, including from the WTO and the EU, the recent wave of PTAs and the APEC process.

LEARNING FROM EXPERIENCE

At present, the EU has achieved the highest degree of economic integration among economies. The members of the EU had free trade by end of the 1960s. But to create anything like an integrated regional economy, they needed to tackle their Single Market Agenda designed to achieve EU-wide mobility of labour and capital, together with extensive harmonisation of regulations and mutual recognition of standards

To implement the Single Market Agenda, members of the EU negotiated binding commitments enforced by a supra-national authority. That approach cannot be used by the G20 to promote cooperation among very diverse economies with no mechanism for enforcing negotiated agreements. Therefore, it may be useful to consider the example set by the Asia Pacific Economic Cooperation (APEC) process of voluntary co-operation among 21 Asian and American governments.

APEC has demonstrated that there is no need to negotiate a comprehensive agreement before making worthwhile, albeit limited,

progress on some dimensions of both shallow and deep integration. The need to cope with diversity has also led APEC to find a way to encourage some governments to implement cooperative arrangements ahead of others, setting examples and encouraging others to follow.

The G20 could seize opportunities for cooperation by following this precedent, while avoiding some of the problems which have beset the APEC process.

PLAYING POSITIVE-SUM GAMES

The experience of the APEC process as well as of PTAs has shown that shallow and deep integration can be promoted at the same time, rather than in sequence. At the same time, it has also demonstrated that negotiations are not always necessary to promote practical co-operation.

Issues such as improving business mobility or better trade logistics do not need to be negotiated. Nor are negotiations sufficient, since practical progress needs more than statements of intent: The effective constraint on action is the capacity to design and implement compatible institutions and procedures.

In many cases, sections of PTAs dealing with facilitation are mere statements of intent. It has been easy for governments to agree in principle to reduce the costs and risks involved. But agreements in principle need to be followed up by creating the capacity to implement practical means of reducing costs or risks of various forms of international commerce. For example, reducing the costs and risks of business travel needs patient work to set up compatible information technology to allow such movement to be combined with obvious security concerns.

This experience points to the potential advantage of dealing differently with various dimensions of economic integration.

The distinction between shallow and deep integration can lead to needless debate about whether it is more important to finish the well advanced task of shallow integration or to refocus attention on deep integration. At present, it is proving difficult to seize opportunities for practical cooperation among economies in the absence of a PTA.

That makes it hard to cooperate with economies which threaten competition to heavily protected products.

It has now become important to distinguish opportunities for economic integration into those where negotiations continue to be needed for progress, from the many issues on which progress does not require negotiations.

Different dimensions of promoting economic integration can be viewed as international games. Almost all of these are positive-sum games, but quite a few are not yet perceived in that way, due to concern about the short-term costs of achieving long-term gains.

The well-understood political economy of trade liberalisation explains that, for the foreseeable future, further reduction of the protection of currently sensitive products will require negotiations

However, negotiations have not been needed for all dimensions of shallow integration. For example, much of the actual liberalisation of applied rates of protection of most products and extensive liberalisation of restrictions on direct foreign investment have been made unilaterally, not in the context of negotiations. The APEC-wide, then WTO, agreement had been made to prevent restriction of trade in information technology products.

Correspondingly, some deep integration measures may need to be negotiated in the short-term; for example, mutual recognition of some products standards or professional qualifications in return for mutual recognition of others.

On the other hand, as noted above, seizing many opportunities to reduce costs or risks of international commerce do not require negotiations, since they are already perceived to be positive-sum games, leading to cooperative arrangements which are in the interest of all participants in these arrangements. Practical examples include the many opportunities to efficiency and security of supply chains.⁷

There is no need to make the implementation of such positive-sum opportunities conditional on each other, nor do they need

⁷ Other opportunities to facilitate trade and investment in ways which do not require negotiations are set out in Andrew Elk, "APEC after Busan: new direction" *APEC Study Series*, 05-01, Korean Institute for International Economic Policy, Seoul, November 2005.

enforcement, since it is in the perceived self-interest of those involved to implement agreed arrangements.

The time has come to group opportunities for cooperation into those which are already perceived to be positive-sum games, as against those where negotiations are needed to make progress in the near future. Such distinction between positive-sum games and others are particularly important for a voluntary process of cooperation.

The successes of the APEC process have been in areas where progress was seen to be of mutual benefit or in perceived self-interest of member economies. As set out in the 2005 mid-term stock take of progress, APEC governments have made substantial progress. There has been significant unilateral of traditional border barriers to trade, encouraged by means of peer pressures and a broad commitment to move towards free and open trade and investment. Voluntary collective action among Asia Pacific economies is already saving billions of dollars per year by practical cooperation to reduce administrative and logistic delays and costs, for example by harmonising customs procedures.

Conversely, the APEC process has not made appreciable progress in areas where short-term political considerations outweigh potential long-term benefits. In these areas, negotiations are needed, which cannot be conducted in a voluntary process of cooperation.⁸

Distinguishing between dimensions of economic integration which do, or do not, need to be negotiated could serve to shape a G20 approach to economic co-operation.

REALISTIC EXPECTATIONS

A further lesson from the APEC process, as well as from the EU experience, is that the task of economic integration is never complete. As technology evolves, there will always be more scope to reduce costs and risks of international economic transactions.

⁸ A mid-term stocktake of progress towards the Bogor goals: *Busan Roadmap to Bogor Goals*, 17th APEC Ministerial Meeting, Busan, Korea, 2005 provides a review of APEC's achievements.

If G20 leaders decide to promote economic integration among such a diverse group, it would be advisable to avoid creating excessive expectations. In the absence of a supra-national authority, progress will depend on widening the range of issues where at least some governments see mutual benefits from implement cooperative arrangements. Patience may be more useful than deadlines.

Despite a creditable record of promoting practical economic integration APEC is widely dismissed as a failure, since APEC governments will not meet the Bogor goals of free and open trade and investment by 2010 for developed economies and are not likely to meet the 2020 for other member economies.

G20 leaders can avoid such a problem. First, by avoiding setting unrealistic deadlines. Second, by setting out a vision of what is to be achieved which reflects the practical needs of those involved in international commerce, rather than a vague ideal such as free and open trade and investment which can never be reached in full.

It is possible to set out a vision of a much more integrated global economy, then look for ways to help each other realise at least some parts of this vision. G20 leaders could explain that they hope to promote cooperative progress towards a global economy with: no, or negligible, border barriers to trade in goods and services, backed by strict limits on contingent protectionism, such as anti-dumping; and on trade-distorting subsidies; national treatment of all direct foreign investment, free movement of business people and capital; transparency, best practice, and consistency of regulations, including competition policy, regulations on government procurement; mutual recognition of standards and qualifications; appropriate protection of intellectual property rights; efficient communications, including e-commerce; best practice logistics.⁹

Some economies already have most of these characteristics; they tend to be the most prosperous, or fastest growing, economies. Others will need to acquire the capacity, including institutional capacity, to

⁹ A list of priorities along these lines was presented by Robert R Romulo in "ABAC inputs to the 2006 APEC agenda" to the *International Symposium on the Preparation for APEC Viet Nam 2006*, Ha Noi, July.

catch up. To a large extent, promoting economic integration among diverse economies involves helping those that want to adapt current best practice by sharing information, experience, expertise and technology. Best practice will continue to evolve, so there will always be scope for such cooperation.

Implementing practical cooperative arrangements, for example to efficiency and security of supply chains will need resources, especially if developing economies are to participate and benefit. Agreements to implement practical arrangements to reduce costs and risks of international commerce will need to be backed by a concerted effort to raise the resources needed for capacity-building.

Most G20 governments are interested in moving towards a vision of an integrated global economy, in the terms set out above. But in a diverse group, it is not realistic to expect all of them to be able or willing to adopt particular co-operative arrangements to realise some dimensions of that vision.

In the APEC process, governments that perceive mutual benefits in potential cooperative arrangements are encouraged to implement them. At the same time, such arrangements are designed so that others are encouraged to participate as soon as they wish to do so, helped by the experience of those who pioneered these arrangements.

Such a 'pathfinder' approach can be adopted by the G20. That would make it possible for some G20 economies to pioneer potentially global co-operative arrangements to promote economic integration, then encourage and assist any other interested economy to participate in practical arrangements to facilitate international commerce.

As already emphasised, there is no need to assume that negotiations will always be needed to make progress. For example, improving the quality and transparency of regulations, or reducing transport and communications costs, is a matter of capacity-building, rather than negotiation.

In other cases, where negotiations are needed to make progress in the short-term, G20 leaders can encourage and oversee negotiations in appropriate forums, including the WTO, but not necessarily at the same time.

MOBILISING RESOURCES

For the many dimensions of economic integration where the effective constraint is the limit of capacity, resources will be needed to make tangible progress. The APEC experience has shown that it is not easy to mobilise resources for capacity-building. The G20 can anticipate this potential problem.

They are embarking on substantial reform of the international financial system; that reform effort could deal with resource mobilisation for capacity-building to support global economic integration. That may require a new institution, rather than adding new items to the already very wide agenda of the World Bank.

CONCLUSION

It remains to be seen whether the G20 can become an effective ongoing forum and whether it will attempt to promote global economic integration. If G20 leaders do decide to tackle this challenge, then it should be possible for them to do so in ways which promise an alternative to the current drift towards discriminatory arrangements to deal with new issues.

The recent experience of the WTO, the EU, PTAs and the APEC process has indicated that not all dimensions of economic integration need to be negotiated. There are many issues on which there is already a shared interest in cooperative arrangements to reduce the costs and risks of international commerce.

This paper has, therefore, sought to sketch out an approach which draws on experience of both voluntary and negotiated multilateral and regional economic co-operation. With care, it should be possible for the G20 to promote both of these in parallel.

The G20 can continue to encourage the WTO, and possibly other negotiating forums, to deal with matters where negotiations are seen to be needed, while encouraging interested governments to cooperate voluntarily on practical issues where there is already a perception of shared potential benefits.

Experience has also shown the importance of marshalling the resources needed to create the capacity for economies, particularly developing economies to participate in cooperative arrangements, for example to enhance the efficiency and security of supply chains. If G20 leaders decide to seize such opportunities for mutual benefit, they may also need to help mobilise the necessary financial resources from international capital market, possibly as part of their overall effort to reform the international financial system.

THE GLOBAL ECONOMIC CRISIS AND ITS IMPACT ON THE HOUSING SECTOR IN EAST ASIA

Hadi Soesastro

INTRODUCTION

East Asia is again in the midst of a financial crisis after having overcome one that happened only a decade ago. This time, the crisis did not originate from within the region, but was affected by the current global financial crisis that was "Made in America". For sure, the effects are likely to be serious.

Nonetheless, there is a belief that the region is in a much better position today to weather a financial crisis than a decade ago. Economic fundamentals are stronger. The banking system has also become much more resilient. Countries in the region have introduced better reporting requirements on private off-shore debt. The region has built up huge foreign reserves. The adoption of conservative financial policies has paid off. On top of that, regional economic integration and the open global markets have expanded and deepened East Asia's production networks. The region was able to recover from a deep crisis within a relative short time.

Today, the external environment is less favourable to aiding the region's recovery than a decade ago. In fact, there are expectations that given the region's huge reserves, it could make a contribution to the recovery of the global economy.

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How countries in region will come out of this crisis situation and how the region as a whole can contribute to global economic recovery will depend on their policy responses, individually and collectively. The impacts of the crisis vary from one regional country to the other, depending on their vulnerabilities. Their ability to implement policies to deal with the shock, real and financial also differs. Regional arrangements should help produce more effective policy responses. This was the real motivation for the creation of the ASEAN+3 process, involving the 10 countries in Southeast Asia and the three countries in Northeast Asia (China, Japan, South Korea) at the height of the 1997/98 Asian financial crisis.

The region is not directly affected by the sub-prime mortgage crisis in the United States that became the source of the global crisis. This is because banks in the region have minimal exposure to those highly risky derivative instruments. The exceptions could be Hong Kong and Singapore. In China and Indonesia, for example, banks have not yet reached a level of sophistication to enable them to participate in those markets.

There was an air of calm and confidence in the region for about a whole year since the outbreak of the sub-prime mortgage crisis in August 2007. By September 2008 several countries in the region began to feel the pinch from the tightening of global liquidity and the emerging credit crunch. A delicate situation began to develop with subsequent drops in the stock markets and weakening of currencies, as governments will now have to cleverly manage public and market sentiments. East Asians still remember how the 1997/98 crisis has unfolded and they became extremely worried about a recurrence of events. If not managed well, this could magnify the challenge of what is called the sudden reversal of external capital, when people withdrew their deposits and exchanged them for "safer" currencies. This happened in Indonesia in 1997/98. Maintaining market confidence and stabilising financial markets were the most immediate challenge.

The housing sector in the region may be the sector that could be immediately affected by the economic downturn, globally and regionally.

THE HOUSING MARKET IN EAST ASIA

House prices in many countries in East Asia experienced rapid increases in 2007. The first observation to make is that this was happening despite the crash in the US housing market and the slowdown in Europe's housing markets. The second observation is that the patterns of house prices developments vary among countries in the region. In general, housing markets in the East Asian economies differ widely due to the different levels of development as well as their different systems. However, for the rest of 2008 and well into 2009 the housing market in all countries in the region could be faced with similar challenges. The third observation is that despite the strong price gains in 2007, house prices in most countries in the region are still below their pre-Asian crisis peak levels. However, it should be noted that there was a real estate bubble, albeit not sustainable, in several East Asian countries in the first half of the 1990s.

Monitoring the movements of house prices is important because housing is generally the single largest investment made by households. The experience during the Asian financial crisis has shown that downward corrections in house prices have caused a major distress to the economy. Are the rapid increases in housing prices since 2007 sustainable? Until a few months ago there was a concern that this development would lead to a new housing bubble. This fear is not unfounded in view of the disastrous housing bubbles in the 1990s.¹ A sharp fall in house prices can unleash systemic risks. The last decade saw a protracted period of significant increases in house prices in the United States and in several other countries, only to be followed by the recent bust in the US housing market, triggered by the sub-prime mortgage crisis. Are we beginning to see this happening in the region?

¹ For example, Japan's housing price bubble from 1985 to 1990 (157%) was followed by a fall in real house prices by 68% throughout 1990 to 2005, and in Singapore the bubble from 1990 to 1996 (282%) was followed by fall in real house prices by 55% over the period 1996-1998. See, Prince Christian Cruz, "Asian property: A decade after the crisis," *Global Property Guide*, 25 July 2007.

ASEAN

Real house prices have experienced a significant drop in all the five original ASEAN countries as a result of the 1997/98 financial crisis. By 2000, real house prices have declined by about 40% in Indonesia, the country hardest hit by the crisis, by about 25% in the Philippines, 20% in Thailand, about 13% in Singapore, and 10% in Malaysia. Prices continued to decline in Singapore and the Philippines until about 2004, remained relatively flat in Indonesia and Malaysia, and began to increase in Thailand since 2003.

It took the region several years to recover from the financial crisis. This was due to the long period of high interest rates following the crisis as well as the economic slowdown that also slowed the growth of the mortgage and real estate markets. In addition, as banks' post-crisis loan portfolios were severely affected by property non-performing loans (NPLs) it had taken them some time before they were willing to expand their mortgage loans. As late as 2005 the NPL ratios were still high in several ASEAN countries.

House prices began to increase in Singapore and the Philippines since about 2005. Demands for housing have been on the rise in most countries in the region as GDP growth appeared to have finally recovered from the crisis, reaching above 5% per annum in all the five ASEAN countries. Driven by its strong GDP growth (7.9%), house prices in Singapore increased by 9.5% (in real terms) in 2006. In the following year, Singapore became the world's best performing housing market.² However, house prices in Singapore were still about 20% below the level in 1995. This was also the case with the other star performance in the ASEAN housing market in 2007, namely the Philippines. The recent increases in house prices there were attributable to the rise in demand from families of Overseas Filipino Workers.³

By 2007 real house prices have fully recovered in Thailand and Malaysia. In fact, house prices in Malaysia have already reached the level of 1995 in real terms in 2004, but they have remained flat since

² Global Property Guide, *Global House Price Report 2007*.

³ Prince Christian Cruz, "A mixed year for Asian residential property in 2006," *Global Property Guide*, 12 February 2007.

then. Since 2003, prices in Thailand have been on the rise, but they declined again in 2006 and 2007, largely due to the political crisis that continues to unfold into 2008.

House prices in Indonesia stayed flat throughout the ten years since the crisis and by 2007 were still at about 50% of the level in 1995. The market has been affected by a series of terrorist bombings and natural disasters, such as the tsunami and several earthquakes. Despite these effects, many new luxury apartments continued to be erected in Jakarta, although prices remain flat. This has not been the case in the Philippines where the price of high-end condos in Manila (Philippines) continues to show healthy growth. Price movements over the past three years in the five ASEAN countries are shown in Table 1. Before examining the latest developments in the housing markets in the ASEAN region it would be useful to review some of the key indicators of the market. As is the case with the East Asian region as a whole, the housing markets in the ASEAN sub-region are quite diverse.

Table 1. Real House Price Increases in Selected ASEAN Countries 2005-2007 (Percentages)

	2005	2006	2007
Indonesia	-8.4	0.5	1.5
Malaysia	-1.2	-2.5	1.2
Philippines	3.6	4.1	3.4
Singapore	2.5	9.5	8.3
Thailand	1.3	-2.4	-3.2

Source: Global Property Guide (various reports, based on country statistics and Colliers International for the Philippines)

One characteristic of the markets in ASEAN is the limited mortgage options. Banks are the main providers of mortgages, and most banks do not offer mortgages with interest rates fixed for more than 5 years. In Indonesia, for instance, most mortgage rates are fixed for only 6 months. The mortgage markets in the region are relatively small with the exception of Singapore, whose mortgage market is at

par with most developed countries, having mortgage debts at 61% of GDP.⁴ The maximum loan to value ratio for new loans in ASEAN is either 70% (the Philippines) or 80% (the other four ASEAN members), with maximum loan terms of 20 to 30 years.

In terms of housing affordability, as measured by the *price to income ratio*, it can be argued that housing in the region is relatively expensive. The *Global Property Guide* has reported ratios of about 7 to 29 in the five ASEAN capitals (Table 2), whereas ratios between 3 and 5 are regarded as affordable.

Table 2. Condominium Affordability in ASEAN Capitals (2006)

	Income per Capita (\$)	Price to Income Ratio*
Singapore	34,153	6.9
Kuala Lumpur	6,146	7.0
Bangkok	3,317	17.6
Jakarta	1,824	24.0
Manila	1,590	28.6

*Assuming a 35-sq m condominium unit in city centre.

Source: Global Property Guide (country statistics)

The high cost of housing is in part due to the high transactions costs (so-called "roundtrip costs"), which is the total cost incurred in buying and selling property, expressed as a percentage of the property value. The roundtrip costs have been estimated to amount to 5.2 and 5.3% in Malaysia and Singapore, respectively, and above 10% in Thailand (10.2%), Indonesia (14.6%), and the Philippines (16.4%).⁵ This may be caused by excessive government intervention in the mortgage and real estate markets.

⁴ Ibid.

⁵ See Prince Christian Cruz, "Why Asia missed the global house price boom," *Global Property Guide*, 23 March 2007.

Another measure to assess house prices is the *price-to-rent ratio*. This ratio is used to measure undervaluation or overvaluation of house prices. If a real estate bubble is progressing, buying prices tend to increase much faster than rents, resulting in a rise in the ratio. This measure could also indicate the yield of the investment, with the lower ratio indicating higher yield. The price-to-rent ratio ranges between 9 years in Indonesia and the Philippines, 11 years and 13 years in Malaysia and Thailand respectively, and 25 years in Singapore. This wide difference in ratios resulted from the much greater difference in square meter prices than the difference in rents between Singapore and the rest.⁶

A study by Glindro *et. al.* (2007) examined whether there were signs of a housing bubble building up in the wider Asia Pacific region. The coverage of the study included four ASEAN countries (Malaysia, the Philippines, Singapore, and Thailand) and two "Plus Three" countries (China and South Korea).⁷ The study found that housing prices tend to be more volatile in markets with lower supply elasticity and more flexible business environment. In recent years some overvaluation was observed at the national level in some countries, but it was not in a dangerous zone as observed in the 1990s. In other countries, the strong growth in house prices was attributable to strong macroeconomic fundamentals. A breakdown analysis showed that overvaluation of house prices that was observed at the national level was contributed mainly by the leading market (or the luxury market) rather than the average market. The breakdown analysis suggested that speculative housing bubbles might exist at particular market segments.⁸

⁶ The square meter price is the average price (\$) of a 120-sq. m. apartment located in the center of the most important city of each country. In 2006 these ranged between \$1,354 (Indonesia) and \$10,723 (Singapore), while the rents ranged between \$1,299 (Malaysia) and \$4,255 (Singapore). For the sq. m. prices see Table 4 in section 3.

⁷ The other countries in the study were Australia, Hong Kong SAR, and New Zealand. See, Eloisa T. Glindro, Tientip Subhanji, Jessica Szeto and Haibin Zhu, "Are Asia-Pacific Housing Prices Too High For Comfort?" December 2007.

⁸ With reference to its findings, the study proposed that house price movements should be included in regular macroeconomic surveillance. For this purpose, the quality and timely availability of city-level housing market data needs to be improved.

In the ASEAN region, the trends at the national level appear to be in line with developments in the luxury residential segment. In this segment, up to 1Q 2008 growth remained healthy in Singapore and the Philippines, stayed flat in Malaysia and Indonesia, and continued to decline in Thailand (Table 3).

The danger of a housing bubble is currently no longer the main concern for the region. On the contrary, the concern is with a slowdown of the housing market in the region, caused by rising inflation and higher interest rates and the unfolding global financial crisis. There was the concern with the effects of the surge in food, fuel and other commodity prices on the housing market. Households in ASEAN are particularly vulnerable to the rise in food prices that effectively reduce their income. Higher interest rates could also discourage borrowing for housing loans. However, since mortgage markets in the ASEAN region are generally underdeveloped, the effect of interest rate movements on the housing markets is mostly indirect, channelled through overall economic performance. The question is whether there will be "synchronicity" in the housing market slowdown in the region.

At the end of the first quarter (Q1) 2008, house prices in Singapore and the Philippines were still rising by 3.75% and 1.66% respectively, albeit at a slower rate than during Q4- 2007 (6.75% and 4.4%, respectively). In the same period house prices in Indonesia increased by a slightly faster rate than in the previous quarter (1.67% in Q1-2008 compared to 1.26% in Q4-2007).

By mid-2008, a slowdown in the global housing market was widely observed. The Singapore market is experiencing a "holding pattern": while prices are not falling, both buyers and sellers are being cautious. The total number of transactions of private homes in Singapore has decreased by 40% since the end of 2007.⁹ However, experts have ruled out a massive decline because of the potentially large multiplier effect from two multi-billion dollar gaming resorts (Integrated Resorts-IRs)

⁹ "Singapore sales down 40%," *Asia Property Report*, 12 June 2008. The report noted that the share of foreign purchases remained the same, at 28%, with Indonesians and Malaysians being the first and second largest buyers.

that are now under construction as well as the development of the new Marina Bay Financial Center (MBFC).¹⁰

Table 3. Luxury Residential Rental Prices and Capital Value in ASEAN Q1-2008

(Percentage)

	Rental			Capital			Yield
	QoQ	YoY	\$/sqm	QoQ	YoY	\$/sqm	
Singapore	1.7	27.4	580	0.0	36.7	21,309	2.7
Manila	1.8	10.9	150	3.9	18.1	2,179	6.8-7.4
Kuala Lumpur	0.4	1.0	151	0.5	3.7	1,955	7.5-8.0
Jakarta	0.0	0.9	144	0.4	-1.9	1,315	10.8-11.2
Bangkok	-1.9	-7.0	125	-0.1	-1.0	2,545	4.9-5.2

Source: Jones Lang LaSalle, *Asia Pacific Property Digest – South East Asia*, First Quarter 2008.

The Philippines remains an attractive market because its property is regarded "as not yet overpriced".¹¹ Philippines real estate market continues to attract investment, most visibly in hospitality and tourism projects as well as residential condos. In view of the housing market slump in developed countries, Morgan Stanley and other major property investment funds appear to be looking to Asia, shrugging off concerns about a market slowdown in this region.¹² Similarly, Middle East investors are also tapping into Southeast Asian property markets, particularly Indonesia and Vietnam.¹³ It remains to be seen whether this new trend will sustain in view of the unfolding global crisis situation. In addition, various efforts to enhance the attractiveness of the housing market in these countries, such as reducing roundtrip costs, will be required.

¹⁰ "Singapore property market slowing down," *Property Wire*, 7 July 2008.

¹¹ "Philippine properties 'hottest' in Southeast Asia," *Philippine Daily Inquirer*, 4 July 2008.

¹² "Property investment funds look East," *Property Wire*, 4 September 2008.

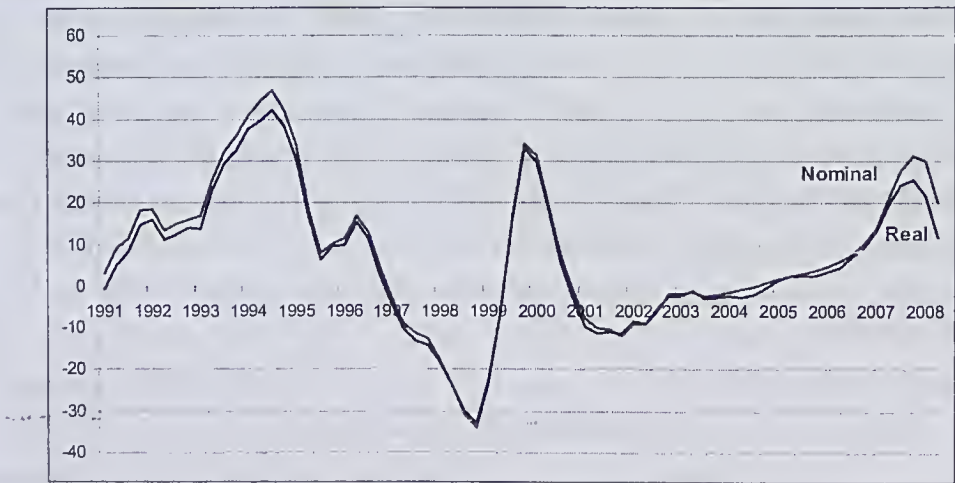
¹³ "SE Asia charms ME investors," *Asia Property Report*, 25 March 2008. It was reported that Limitless, the property arm of Dubai World, bought a \$110 million, 30% stake in three units of Indonesia's biggest property developer by value, PT Bakrieland Development.

Singapore

The recovery of the housing market in Singapore since 2004 has been mainly due to strong economic growth: 8.7% in 2004, 6.4% in 2005, 7.9% in 2007, and 7.7% in 2007. The housing market has also been significantly boosted by policies implemented in 2005, namely relaxation of foreign ownership of apartments, an increase of the maximum loan-to-value from 80% to 90%, and a reduction of cash down payments from 10% to 5 % for home purchase. Mortgage interest rates have remained flat over the past two years.

The government has recently reduced its growth forecast for 2008 from 4-6% to as low as 3%. By Q3- 2008 Singapore appeared to have felt the full impact of the global financial crisis as the economy was officially in recession. The residential price index dropped by 2.4% QoQ, the first time since March 2004.¹⁴ Prices fell across the board, with prices for high-end houses in prime areas experiencing the biggest drop (2.7%). In Q1-2008 the growth was still 3.75%, but by Q2 it already declined to a mere 0.4% in Q2-2008, as the economy grew by only 2.1% compared to 6.9% in the previous quarter.¹⁵

Graph 1 Singapore – Housing Price Change, Annual (%)



Source: Urban development Authority: CPI from Department of Statistics

¹⁴ Singapore's Q3 private home prices down 2.4% on-quarter, *Channel NewsAsia*, 24 October 2008.

¹⁵ See Colliers International Singapore, *The Knowledge Report*, July 2008.

Earlier, a reversal in the pattern of price developments was thought to have taken place in Singapore. In 2007, the residential property price index was still driven by the considerable rise in the price of high-end and luxury apartments, but in the first half of 2008, mass-market properties were leading the price growth (1.3% QoQ in Q2). However, by 3Q the mass market also fell by 1.5%, and luxury apartment prices appear to have finally succumbed to downward pressures. Several major condominium projects have been completed, and rents "began to soften in the face of resistance by multinational companies on the back of the higher cost of living stemming from the soaring inflation rate."¹⁶

According to Jones Lang LaSalle, the property market in Singapore is also affected by rising construction cost. The effect will be felt more by suburban projects as construction costs are usually at a bigger proportion to land costs compared with the high land prices in prime residential projects. Thus, the increase in construction costs will have a greater impact on profit margins for mass-market projects. Nonetheless, developers are unwilling to post prices of mass-market properties beyond a certain level for fear of being priced out of the market.¹⁷

In the short term, house prices are likely to remain soft in Singapore, although the long-term prospects remain promising. The very significant IRs and the MBFC projects, referred to earlier, could help maintain the confidence of the market if these mega projects are completed as planned. The Singapore housing market is currently experiencing a necessary correction.

The Philippines

The economy of the Philippines has posted a strong GDP growth of 5 to 6% since 2004, the year the country's real estate sector began to recover from the slump. At the beginning of 2008 growth was

¹⁶ Ibid.

¹⁷ See Jones Lang LaSalle, *Property Market Monitor*, Singapore Edition, August 2008.

expected to reach 5.4% for the year, but the forecast has since been revised downwards to 4.2% to 4.5%.

Demand for residential properties has been strong, especially for luxury apartments in Metro Manila. Prices rose by 15.15% (in nominal terms) in 2007, following a rise of 9.6% in 2006 and 10.9% in 2005. Overseas Filipinos Workers (OFWs) have been the main buyers of luxury residential units, mainly for investment. It was reported that about 30% of the income of OFW is spent on housing. Remittances of OFW in 2007 were in the order of US\$15 billion, and expected to increase by 8% in 2008.¹⁸ In addition, boosted by the growth of the call centre industry, condominium projects have been rising not only in the Makati Central Business District (CBD) but also in other parts of Manila. Condominium prices and rents have been on the rise since the recovery from the crisis starting in 2004. Foreigners can purchase condominiums as long as the foreign component of the building does not exceed 40%. Foreigners can also lease land for up to 75 years.

As can be seen in Table 3 above (previous section), in Q1-2008, rentals still increased by 10.9% (YoY) and capital values rose by 18.1% (YoY), albeit less rapid than in 2007. Residential prices have begun to see a slowing down as they appreciated by less than 2% in Q1-2008. It was expected, however, that prices might further rise by 8% for the rest of 2008, making the Philippines still a star performer in the region.¹⁹

The real estate boom in the Philippines has been characterised by the number of new condominiums rising all over Metro Manila. This is distinct from the pre-Asian Crisis boom that was visible mainly in Makati CBD. New condominiums are being planned and built along the entire stretch of EDSA. There are also new condo projects planned in the North and South.

However, a few problems have been identified with the housing market in the Philippines. First, the demand that has been driven by the OFWs is vulnerable to exchange rate changes. An appreciation

¹⁸ Colliers International Philippines, *The Knowledge Report*, April 2008.

¹⁹ Ibid.

of the peso against the dollar would reduce the OFW's purchasing power in the Philippines. According to a Consumer Expectation Survey for Q4-2007, only 1.3% of OFW households intend to use the remittance for purchasing a house, much lower than the 10.9% in Q2-2006. It remains to be seen what the effect of the global crisis and peso depreciation will have on OFWs demand for houses in the Philippines.

Second, transactions cost (roundtrip cost) of property purchase is still relatively high in the Philippines. It is around 16.23% to 23.75% of the property value, inclusive of Capital Gains Tax (6%) and Real Estate Agent's Fee (3% to 5%). It takes about 33 days to go through the eight procedures needed to register a property in the Philippines.

Third, limited mortgage options continue to hamper the real estate market in the Philippines. Experience in other countries has shown that a housing market boom is usually accompanied by a mortgage boom as most property purchases are financed by a loan. In the Philippines, despite the ongoing real estate boom, loans to real estate, renting and business activities have contracted by 7% from Q4-2006 to Q1-2007. The few banks that dominated the mortgage market have been severe in their lending, particularly since the 1997/98 crisis. Homebuyers are required to put substantial cash down payments.

Despite the drop in the base interest rates, mortgage rates offered by major commercial banks also remain high. This means that the borrower absorbs much of the interest rate risk. Mortgages offered by developers are significantly much higher, ranging from 12% to 18%. Furthermore, despite the relaxation of rules on real estate lending, many fundamental problems confronting the real estate sector remain to be addressed, including reforms in credit rating, property valuation, land administration and property registration.

By Q3-2008 there were signs that the global financial crisis has slowed down the Philippines real estate boom. Although luxury condominium prices appear to continue to rise, the residential sector has been slowing down. Demand from Overseas Filipinos is also weakening. An oversupply of residential condo units appears to be looming. In view of these developments, the housing market in the

Philippines is expected to slow down. Concern about this prospect has led to a recent decision to defer the implementation of a new accounting rule stipulating that property buyers' payments cannot be booked as revenues until projects are completed. This regulation would have taken effect in January 2009, but it has been put off until 2011 to protect the property market.²⁰

Thailand

The housing market in Thailand has remained stagnant throughout 2007 in large part due to the political turmoil since the September 2006 coup by the military. Overall property prices fell by 0.8% from the previous year.

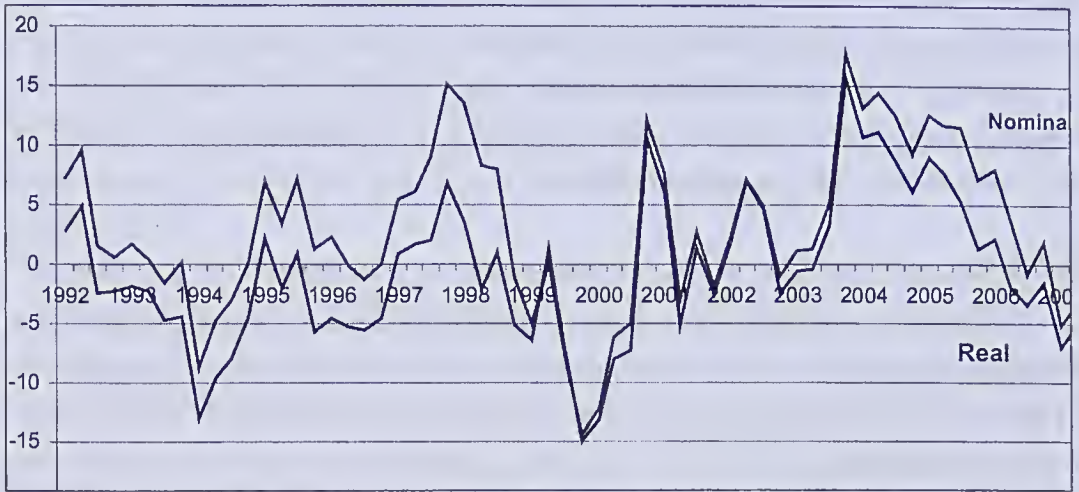
However, in the first half of 2008 prices of condominium in downtown Bangkok were on the rise, particularly in the CBD or the Riverside, due to the demand from foreigners.²¹ Foreigners cannot own land in Thailand, but can own condominiums as long as the percentage of units sold to foreigners does not exceed 49%. Before the coup, foreigners often bought detached homes with land through a nominally Thai-owned company, but the authorities have since cracked down on nominee structures. Now most property sales to foreigners are leasehold. Foreigners can obtain 30-year leases that can be renewed twice.

A positive development to note is the reduction in transactions costs since the implementation of the government's tax incentive program at the end of March 2008. It remains to be seen whether this policy will be continued by the new government. The roundtrip costs are now estimated to be around 4.8% to 7.1% of the property value.

²⁰ "New regulations postponed in Philippines amid fears about impact on property market," *Property Wire*, 11 November 2008.

²¹ Jones Lang LaSalle, *Market Review – Thailand*, Second Half 2007.

Graph 2 . Thailand– Housing Price Change, Annual (%)



Source: Government Housing Bank; CPI from Bureau of Trade and Economic Indices, Ministry of Commerce

To prevent a market downturn, real estate associations of Thailand have asked the government to extend the real estate tax and fee reduction incentives that were set to expire in March 2009. This request is being considered by the government as the real estate sector is seen as a key sector in stimulating the economy.²² These associations have also urged banks to loosen their home-loan approval conditions and to cut interest rates in order to help the property industry.²³

Malaysia

In 2007 property prices have been increasing despite weak developments during the first half of that year. The strong growth of residential prices has been caused by strong economic growth, at 6.3% in 2007, up from 5.9% in 2006. In addition, low interest rates have led Malaysian households to look for investment alternatives to place their money in the bank. The volatility in the equity market has

²² "Thai real estate industry calls for incentives to prevent property downturn", *Property Wire*, 29 October 2008.

²³ "Thai banks urged to loosen property lending restrictions", *Property Wire*, 13 November 2008.

been another factor. In 2007 house prices in Kuala Lumpur increased by 5.7% in real terms, following price increases of 1.7% in 2006, 3.35% in 2005, and 5% in 2004.

By the middle of 2008 there was the concern that the housing market in Malaysia may weaken. Political uncertainty could be a factor, but the weak consumer and business confidence as well as increased inflation have led to a slack in demand for housing.²⁴ By early December 2008, it appeared that Malaysia's property prices have remained stable, especially in the major growth areas. Essentially, the fundamentals of the property market are strong because there is ample liquidity in the domestic banking system. However, as buyers have become cautious, major property developers are reviewing their plans, given the substantial amount of oversupply of mid-price to luxury condominiums, especially in Kuala Lumpur.²⁵

Industry officials believe that the Malaysian property market is still attractive in terms of prices. Properties in Malaysia indeed are amongst the cheapest in the region. In addition, regulations on foreign purchases of property are more lenient than in other ASEAN countries.²⁶

Foreign investors have been eyeing at Malaysia because it offers much better investment than Singapore or Hong Kong. In 2007, "foreigners bought almost everything."²⁷ However, there have also been a lot of speculative activities in Malaysia's residential market by local and foreign investors.²⁸ The gross rental yields in Malaysia have stood at around 7%. In December 2006 the government has relaxed the rules on foreign ownership. Foreigners are no longer required to ask

²⁴ The Real Estate and Housing Developers Association (REHDA) of Malaysia has expressed the concern about the uncertain outlook of the market for the rest of 2008 because of the weakening of local demand as well as foreign buyers from traditional markets, and that smaller builders without strong reserves may not survive. See, "Malaysia property market slowing as developers warn of soaring costs," *Property Wire*, 23 July 2008.

²⁵ "Property market holding out well," *Malaysia Star*, 6 December 2008.

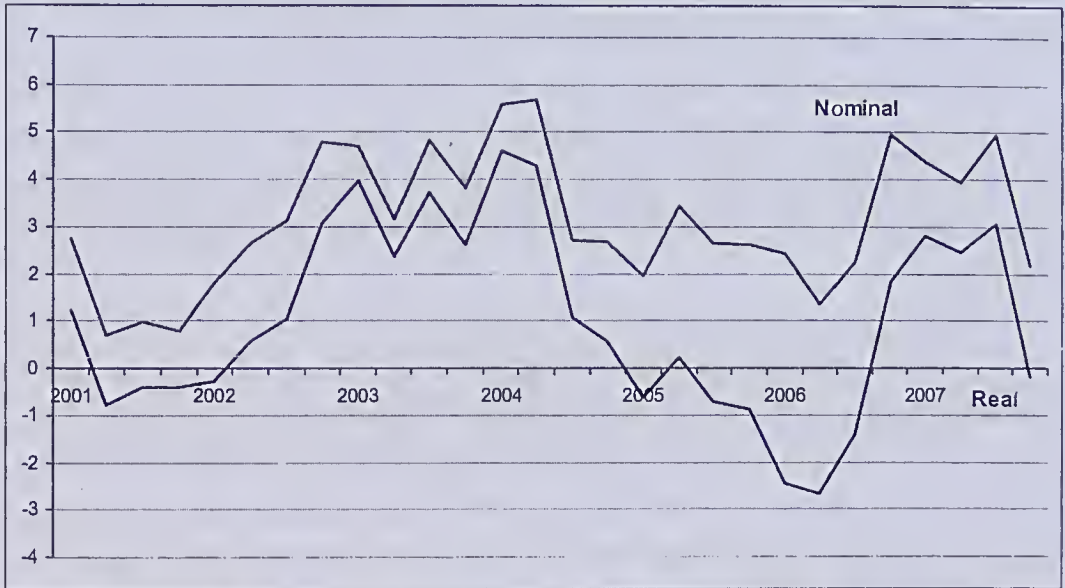
²⁶ "Malaysia to launch a 'charm offensive' to attract foreign property investors," *Property Wire*, 4 November 2008.

²⁷ "Malaysian property market slowing as developers warn of soaring costs," *Property Wire*, 23 July 2008.

²⁸ Jones Lang LaSalle, *Asia Pacific Property Digest – Southeast Asia*, Fourth Quarter 2007, 31.

for permission from the government to buy properties above a certain value (approx US\$74,000). The limit on the number of properties foreigners can buy has also been removed, and there are no longer any restrictions on the use of property. Before, foreigners could only buy no more than two units, and they could not use them for investment purposes. In addition, the government has abolished capital gains tax in April 2007 to boost the property sector. Previously, non-resident individuals were charged Real Property Gains Tax (RPGT) at a flat rate of 30% on gains made on the disposal of real property within the first five years, and 5% thereafter.

Graph 3. Malaysia– Housing Price Change, Annual (%)



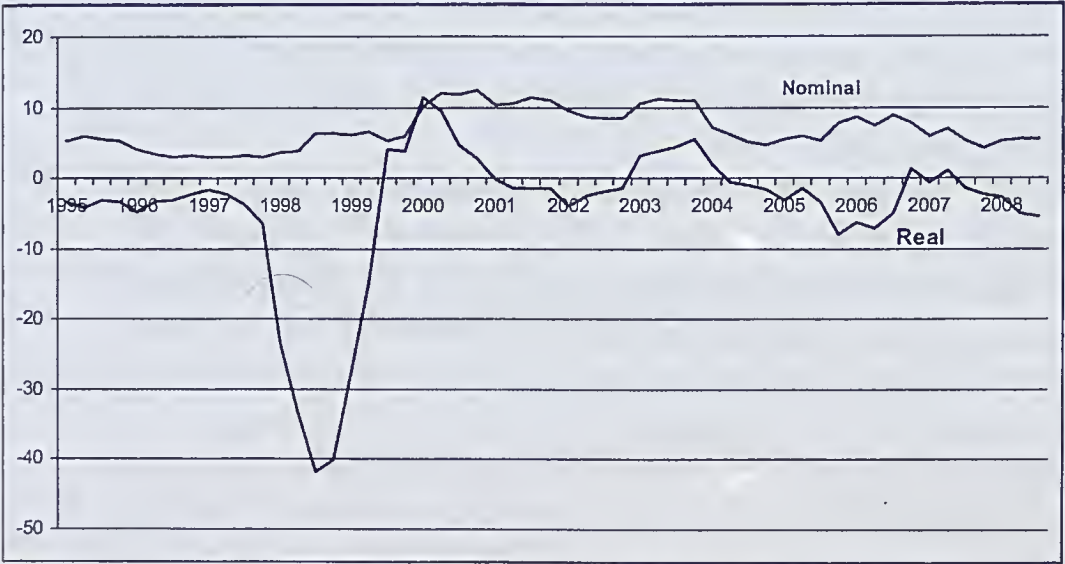
Source: Valuation and Property Services Department, Ministry of Finance;
CPI from Department of Statistics

Indonesia

House prices in Indonesia have not increased despite the property boom. Residential prices rose by only 5.4% in 2007, following an increase of 6.6% in 2006. In early 2008, the house price index was still about 50% below its peak in 1994 in real terms. It should not be overlooked, however, that small houses have risen in value much faster than large units.

Overall, demand has been growing at a slower pace compared with supply growth. The buyers are dominated by investors. Unlike in Malaysia, foreigners do not play an important role in the market because of the ownership issue. Theoretically, foreigners can own condominiums or strata-title residential property (apartments). However, a decade after Regulation 41 of 1996 was issued no foreigner has actually received a strata title certificate of ownership.²⁹

Graph 4. Indonesia- Housing Price Change, Annual (%)



Source: Bank Indonesia; CPI from National Bureau of Statistics

The economy grew by 6.3% in 2007, following 5.5% GDP growth in 2006. Throughout 2007 mortgage interest rates were all falling. In the stock market, property counters have strongly outpaced the general market. The property boom in Indonesia has continued until about September 2008. Since then the market began to experience a slowdown. Around 83% of Indonesia’s gross fixed capital formation in 2007 was spent on buildings. Most visible development is in Jakarta although the property boom has spread throughout the country. The supply of condominiums and strate-title apartments in Jakarta

²⁹ Global Property Guide, "Indonesia", 6 May 2008.

has greatly increased. Until last year, they are mostly concentrated in the CBD and South Jakarta, but since the beginning of this year they have begun to spread out in other parts of the city. The Jakarta condominium market is dominated by middle grade and lower-middle grade projects. In addition, the government has introduced a program to build low-cost (subsidised) apartments towers in Jakarta.

By Q2-2008 some improvements in condominium prices have been observed. In part this was because developers had to cover for increased construction costs. At the same time, apartment rentals grew at a slower pace due to continued modest demand growth.³⁰ In fact, the national house price index rose 5.6% during the year to the end of Q2-2008, but adjusted for inflation it actually saw a fall by 4.2% as inflation soared.

As is the case with the Philippines, total roundtrip cost of buying and selling a property in Indonesia is high, between 25.5% and 47.5%. The 20% Sales Tax on Luxury Goods and VAT of 10% make up most of the total expenses. The seller only pays for the 5% agent's fee, while the buyer shoulders all other transactions costs, including the Transfer Tax of 5% and a 5% Tax on Acquisition of Land and Building.

The government is contemplating to extend the property usage rights of foreigners to 70 years from the current 25 years by allowing for two extensions of 20 and 25 years. It remains to be seen how this would affect property prices.

Vietnam

Vietnam has experienced a property boom until about April 2008 when the government began to tightening bank credit for real estate transactions following the stock market crash.

Vietnam has been experiencing spectacular growth of suburbs and apartment blocks, driven by more than 8% annual economic growth and a stock market that has given investors ready cash to spend. As reported by the *Global Property Guide*, at one point in 2007 "investors were queuing overnight to buy condominium units,

³⁰ Jones Lang LaSalle, *Jakarta Property Market Review*, Second Quarter 2008.

with prices of good-quality projects hitting \$3,500 per square meter - around the same price as an average grade-A condominium project in Bangkok."³¹ Prices doubled in 12 months, nearly tripled in some cases in 18 months.

Foreign investors have also entered the Vietnamese property market. In fact, freehold land does not exist in Vietnam. Land can only be leased, even by Vietnamese. Under Decree 94 (May 2007) foreign investors can lease land for 70 years, extendable without additional payment, i.e., a perpetual lease.³² Developers from Hong Kong, Singapore, Korea, Japan and Thailand have rushed in to take advantage of the opportunities.

As inflation hit 25% in the middle of 2008, the stock market has plummeted and property prices have been falling. The government was forced to lower its growth target. The prevailing mood has turned sour.³³ Vietnam has learnt a lesson from a boom-bust situation that it was not fully equipped to handle. Perhaps this serves as a good reminder to other countries in the region.

Cambodia

Cambodia has experienced a spectacular property boom when prices surged 25% to 40% annually from 2004 to 2007. The boom that began in Phnom Penh has spread across the country. In Phnom Penh several mega projects are being built, including a 42-story twin condominium. Around 70% of the buyers are reported to be Cambodians.³⁴ A satellite city, Camko City, is being developed in northwest Phnom Penh by a South Korean company. The US\$ 2 billion project will include residential units, villas, condominiums, commercial and public facilities, trade and financial centres, office buildings, shopping centres, hotels, schools and hospitals. In Siem

³¹ Global Property Guide, "Vietnam," 20 May 2008.

³² With this perpetually renewable lease, Vietnam now has one of the most open property markets in Asia. China only offers 70-year leases, not renewable, to foreign investors. Thailand offers foreigners 30-year leases, with the possibility of one or maybe two 30-year extensions.

³³ See Ben Stocking and Vu Tien, "Optimism turns to anxiety as Vietnam's boom economy goes bust," *International Herald Tribune*, 17 June 2008.

³⁴ Global Property Guide, "Cambodia," 23 October 2008.

Riep, where the world famous Angkor Wat is located, land prices have risen 25% to 30% every year since 2004.

A mortgage market has developed in Cambodia, but it is still in its infancy. There are about 100 property developers now operating in Cambodia, and most of them are small. To protect property investors from fraud new regulations are being introduced. They include a requirement for developers to deposit 2% of the projects' total value at the National Bank of Cambodia before they are given the go ahead to begin with the construction. Payments from buyers will be held in that account to make the payment system more transparent.³⁵

A downturn was beginning to be visible in July 2007, perhaps due to the new investment guidelines for developers issued by the government. Real estate sales have plummeted 30% to 50% from a year earlier. But the bubble actually burst in the middle of 2008. Between June and October 2008, property prices fell between 10 and 20%.³⁶

South Korea is the most important real estate investor in Cambodia. As South Korea has been severely affected by the global financial crisis, a number of Korean investors have pulled out.³⁷ It remains to be seen whether the impact on Cambodia will be limited to the real estate sector or becomes more widespread.

NORTHEAST ASIA

As in the ASEAN sub-region, the patterns of house prices developments also vary amongst the Northeast Asian countries, but for all of them 2007 was a good year for the property sector. In South Korea prices increased significantly in 2006, which continued in 2007, before slowing down markedly in 2008. In China, housing price changes slowed since the latter half of 2005 until early 2007, but increased substantially since Q2-2007 and began to slowdown again since the beginning of 2008. In 2007 there was also a significant

³⁵ "Cambodia introduces new regulations for developers and real estate agents," *Property Wire*, 30 August 2008.

³⁶ Chun Sakada, "Real Estate prices Continue to Fall," *VOA Khmer*, 3 November 2008.

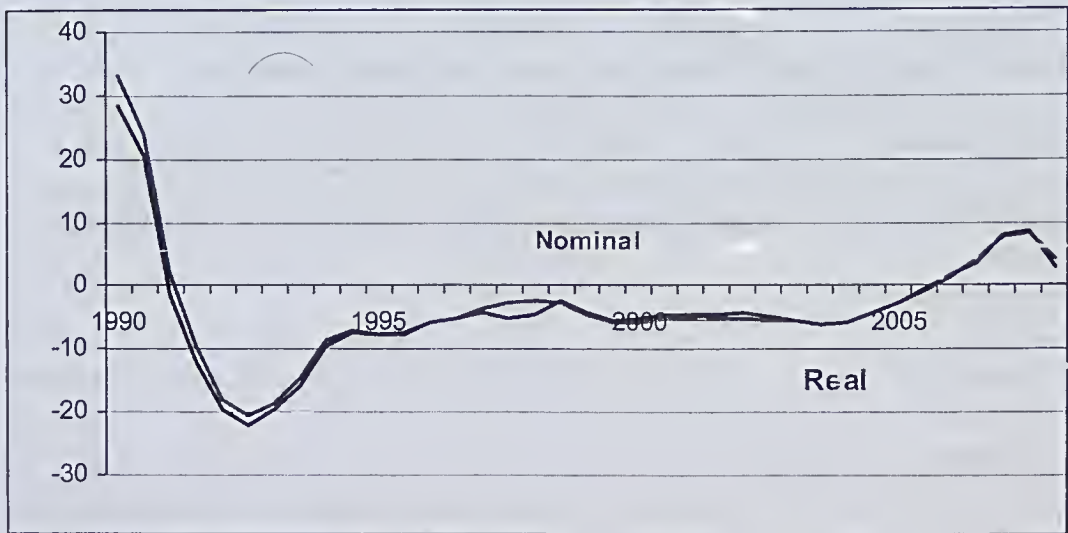
³⁷ "Asia bracing itself for downturn in property markets," *Property Wire*, 11 October 2008.

recovery on Japanese property prices. Using land prices (six cities land price index) as a proxy for residential prices, there was an 8.4% increase during 2007.³⁸

Japan

Japan's real estate bubble from 1986 to 1990 was followed by a deep slump that lasted for more than a decade. Land prices plunged by as much as 70% in some areas. A major turnaround takes place in 2006 when prices finally started to recover. One contributor to the recovery has been the establishment of the Real Estate Investment Trust (J-REIT) in 2000 that opened the real estate market to new sources of financing.

Graph 5. Japan – Housing Price Change, Annual (%)



Source: Japan Real Estate Institute; CPI from Statistical Bureau

Since the beginning of 2008, Japan's property market experienced a slowdown due to the credit squeeze. By Q3-2008 Japan is officially in a recession. As residential, as well as commercial, real estate markets are slumping, there are concerns that property developers,

³⁸ Land prices are used as proxy because Japan does not have house price statistics. Land prices for residential buildings are produced by the Japan Real Estate Institute.

contractors and other property companies could face bankruptcies if banks continue to cut real estate lending. The latest figures from the Real Estate Institute show that there are now only 203 real estate developers compared with 547 in 1995.³⁹

Japanese housing market is still seen as a good investment option. Since housing prices have fallen faster than rents, gross rental yields are generally high. They have ranged from 4.7% to 7.2%, much higher than the prevailing mortgage interest rates of around 2%.⁴⁰ From 1995 to 2005, rents in Tokyo had fallen by 10.7%, but over the same period residential land prices in Tokyo fell by 40%. However, due to limited space, apartments in Tokyo have always been very expensive. Table 4 exhibits square meter prices for selected East Asian countries with Japan on top of the list and Malaysia and Indonesia at the low end of the list.

Table 4. Square Meter Prices – Selected East Asian Countries
(US dollars)

Country	\$/Sq.m.*
Japan	16,052
Singapore	10,723
China	2,697
Cambodia	2,503
Thailand	2,492
Vietnam	2,070
Philippines	1,939
Malaysia	1,366
Indonesia	1,354

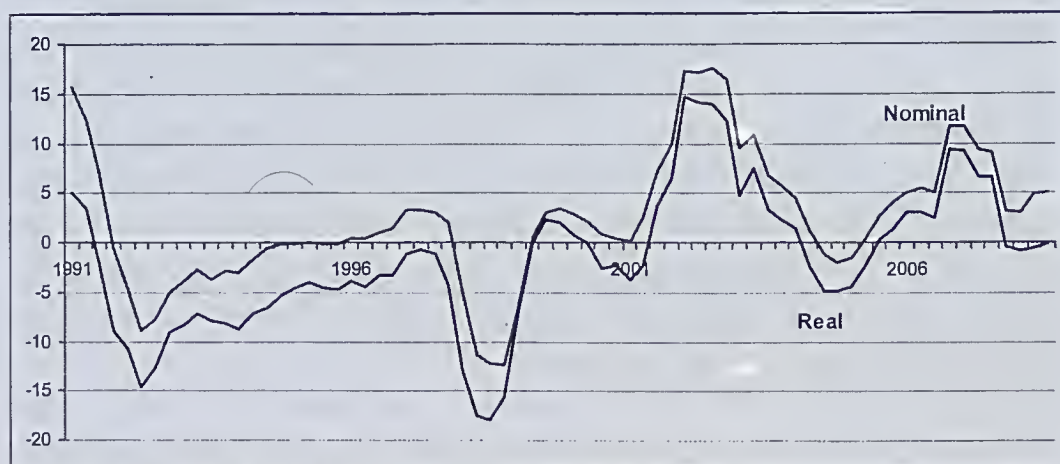
* Average per square meter prices of 120 sq. m. apartments located in the centre of the most important city in the country.
Source: Global Property Guide (country statistics).

³⁹ "Property prices in Japan fall as more real estate businesses go bust," *Property Wire*, 16 November 2008.
⁴⁰ See Global Property Guide, "Japan," 30 April 2008.

South Korea

Starting in 2006, South Korea saw a strong rebound in property prices, despite efforts by the Roh Government to depress the market. President Roh's left-leaning view was that house prices in Korea were too high. He introduced a number of measures to slow price gains. These included raising capital gains taxes by as much as 60%. Nonetheless, property prices continued to increase in 2006 by 6% (3.8% in real terms) from 0.8% in 2005 (-1.9% in real terms). In 2007, property prices further rose significantly by 9.1% (6.4% in real terms).

Graph 6. South Korea – Housing Price Change, Annual (%)



Source: Kookmin Bank; CPI from National Statistical Office

In 2008 Korea's housing market could be heading down as house prices declined by 0.4% (in real terms) to the end of Q2-2008. In fact, the year began with a note of optimism with the inauguration of President Lee with the high expectation that he would reverse the misguided housing policy of the outgoing Roh Administration. Unfortunately, South Korea is seriously affected by the global financial crisis.

A major concern for South Korea now is the severe glut in new housing over the next several years. Large-scale developments began with the 2002 government announcement to build five million housing units within ten years. About 500,000 units have since been constructed annually. However, the market is now faced with an

increase in the number of unsold apartments. In August 2008, there were close to 130,000 unsold apartments.⁴¹

Mortgage loans have increased by an average of 12.5% annually from 2004 to 2006 at the time when interest rates for housing loans dropped to below 6% from a peak of more than 15% at the time crisis. Since 2007 these loans began to decline as a series of measures to curb property prices were implemented.

Interest rates have increased since the beginning of 2008, and reached 7.16% in August 2008. However, in September 2008, in an effort to increase liquidity to overcoming the credit crunch, the Bank of Korea has reduced its base rate. In the same month the government also adjusted real estate taxes for houses in order to help boost the construction sector. Other policy measures include the buying up of unsold homes (to the amount of US\$ 1.5 billion) from builders, through the Korea Housing Guarantee Co., under a repurchase agreement.

Mr Shin Dong-hyun, a director at Daewoo Engineering and Construction, believes that the problem is a "short-term oversupply of apartments" and is confident that the three apartment complexes he is building in the Cheonan-Asan New Town will all be sold eventually if government policies are changed.⁴²

China

In 2007, of the "Plus Three" countries, China experienced the highest rise in residential property (house) prices. The price increase (QoQ) was 6.5% in Q2, 14.7% in Q3 and 10.4% in Q4, before declining in 2008 to 4.4% in Q1, 3.1% in Q2, and -1.1% in Q3.⁴³ The boom and bust in China have been the most pronounced amongst countries in East Asia.

In 2007 China began to seriously tackle the rise in inflation, the highest rate it has experienced since 1996. The economy had been growing at about 10% for many years and the country experienced

⁴¹ Global Property Guide, "South Korea," 23 October 2008.

⁴² "Home prices in South Korea Stalling at a High Point," *The New York Times*, 18 December 2007.

⁴³ Global Property Guide country report on China, 1 September 2008.

a massive construction boom during the past decade. To cater to the rapidly rising middle class, huge housing complexes with hundreds of thousands of new units were built in or near major cities.

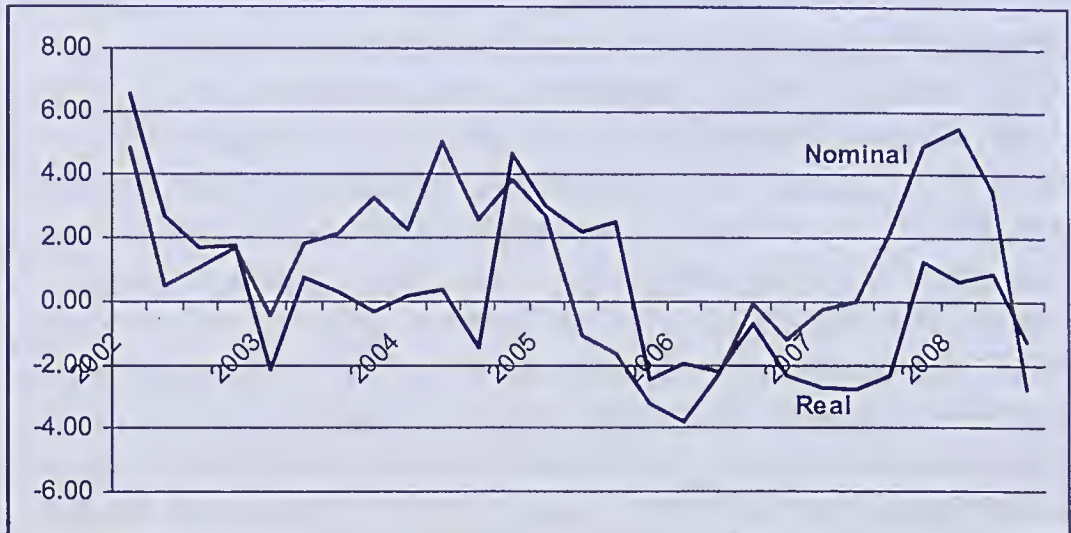
The entry of foreign developers from Singapore, Hong Kong, Taiwan, US and Europe has further increased housing supply. The strongest price rises for new housing projects were in outlying areas. Beihai, the coastal city in southern Guangxi province across from Hainan Island, posted an 18.6% rise in sales prices in July 2007 from the year before, followed by Shenzhen, the special economic zone bordering Hong Kong, where prices rose by 16.1%. They were followed by Nanning, the "green" capital of Guangxi province, 12%; Urumqi, the capital of the remote north-western autonomous region of Xinjiang, 12%; and Beijing, 11.6%. On the second-hand market, prices increased by 21.4% in Shenzhen.⁴⁴

The government has adopted various measures to slow the boom. These include the introduction of a property business tax and stricter control over land supply. If property is held for less than two years, sellers have to pay a 5% business tax on the total transaction price. If held for more than two years, the seller has to pay a tax on the capital gains only, which is usually 5%. The deed tax has also been raised from 1.5% to 3%. In addition, a seller must pay off the entire mortgage before the property can be sold. China also has in place many punitive policies toward those who buy real estate as an investment.

In Q4-2007, the government further restricted housing loans for second house purchases. Down payment must now be at least 40%, and the loan interest rate must be at least 10% higher than the People's Bank of China benchmark rate.

⁴⁴ "Housing Markets Gets Hotter in China," *Forbes.com*, 17 August 2007.

Graph 7. China – Housing Price Change, Annual (%)



Source: China National Bureau of Statistics

However, the real estate bubble is now turning into a bust in many cities in China. The post-2008 Olympics slump in Beijing had been foreseen, but this has been exaggerated by the unfolding of the global financial crisis. The policy reversal began in the middle of October 2008 when the government announced a series of measures to firm up real estate prices. Commercial banks were instructed to reduce mortgage interest rates and down payments for borrowers obtaining their first mortgage. Mortgage interest rates were subsequently reduced by 0.27% for first-time buyers for mortgages of five years or more.⁴⁵

There are concerns that difficulties faced by the real estate sector would lead to serious problems in the banking sector. However, it could well be that the relative lack of sophistication of the Chinese mortgage system could keep the real estate boom or bust from expanding into a credit and financial crisis. For one, mortgage lending in China is still tightly regulated. Furthermore, roughly 50% of home buyers in China still pay cash for their homes. First-time buyers who

⁴⁵ "Chinese banks brace for housing aftershock," *International Herald Tribune*, 23 October 2008.

obtain mortgages are required to make a down payment of 30%. Buyers who have a mortgage on another home must make a down payment of 40%. The new measures have reduced the down payment to 20% for first-time home buyers.

The government faces the danger that a rapid or broad relaxation of monetary policy in response to real estate difficulties could reignite inflation. This is a serious issue for China, but it is currently perhaps more concerned about the rising unemployment.

Real estate difficulties have started to affect the construction industry as well. Cities in China's interior regions appear to be the least affected by the current difficulties. It is the export-dependent coastal cities in mainland China that have experienced the steepest downturn in their real estate markets that further exacerbated the growing economic difficulties in these parts of the country. As they are already closely integrated economically with the East Asian region, these difficulties could bring about serious regional repercussions.

CONCLUDING NOTES

Based on this brief review of house price developments in East Asia the following three points can be made. First, the property sector in all countries in the region is already affected by the global economic downturn. The magnitude of the effects may differ from one country to the other, but all countries need to ensure that the fall in house prices would not unleash systemic risks, within each of the economies as well as region-wide.

Governments will look for ways to protect this sector as housing is the single largest investment made by households. They may even consider providing various incentives to this sector to help stimulate the economy. However, this will need to be based on clearly defined national housing policy that should not be skewed towards the high-end segments of the market.

Second, monitoring house price movements in the region should become a part of the regional surveillance exercise, such as within the EPRD (Economic Review and Policy Dialogue) process under the ASEAN+3 framework. This process, which has been established for

the purpose of ensuring economic and financial stability in the region, will need to be strengthened.⁴⁶

Third, for an effective surveillance process the region needs to begin to improve collection and publication of house price data. This should become an important agenda for cooperation in the ASEAN+3 framework, and should be undertaken systematically.⁴⁷

⁴⁶ For an excellent assessment of this surveillance process, see Tetsuji Murase, "Economic Surveillance in East Asia and Prospective Issues," *The Kyoto Economic Review* 76(1); 67-101 (June 2007).

⁴⁷ For a discussion on the methodological issues, see Stephen V. Arthur, "Residential property prices: a synopsis of available data and related methodological issues," paper prepared for the OECD/IMF workshop on real estate prices indexes, 6-7 November 2006, Paris (<http://www.oecd.org/dataoecd/29/3/37629979.pdf>).

ALI ALATAS: INDONESIA'S TOP DIPLOMAT

*Wiryono Sastrohandoyo, Jusuf Wanandi, Sabam Siagian,
Nugroho Wisnumurti, Ed Masters*

On 11 September 2008, Ali Alatas passed away in Singapore of a heart attack. Ali Alatas was one of Indonesia's most widely respected foreign ministers. A charismatic man, he was respected internationally for his experience and diplomatic skills.

Alatas was born in Jakarta. He graduated from the Academy for the Indonesian Foreign Service in 1954 and the University of Indonesia's law faculty two years later. As a career diplomat, he was posted in various embassies of Indonesia, including those in Bangkok and Washington DC, and he twice served as Indonesia's ambassador to the UN, in Geneva from 1975 to 1978 and in New York between 1982 and 1988. That year, in the final decade of Suharto's 32-year reign, he became Indonesia's foreign minister, and after that serving another year under Habibie presidency.

In 2001, Alatas compiled a selection of his speeches into a book, *A Voice for a Just Peace*. It highlighted Indonesia's desire for economic

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and social justice on a global scale, demanding an end to nuclear testing and the reform of the UN to end superpower domination. In 2006, Alatas published another book entitled *The Pebble in the Shoe: The Diplomatic Struggle for East Timor*, where he put to rest the lingering myths about Indonesia and East Timor, and yet stir a wider debate about the occupation.

Some successes gave proof to buttress Alatas' reputation as an international statesman. His greatest accomplishment was his work with the Cambodian Prime Minister Hun Sen, who had been appointed by the invading Vietnamese in 1978; Alatas brokered the historic 1991 peace settlement at the Paris International Conference to end the war with the Khmer Rouge.

The Indonesian Quarterly has compiled five articles by Ali Alatas' dear friends. This serves as a tribute to a person with whom we had a chance to work closely and whom we greatly admire.

Wiryono Sastrohandoyo: *Ali Alatas, the Ultimate Diplomat*

It was my good fortune to have worked under the leadership and guidance of Pak Ali Alatas—first when he was Indonesia's Permanent Representative to the UN in New York where I was one of his deputies, and later during his tenure as Foreign Minister when—for three years—I was Director General for Political Affairs, and also while serving as Ambassador to Austria, then to France and then to Australia.

Working under his wings, I witnessed up close most of his achievements during that challenging period when he was Foreign Minister. He shared with me and all his colleagues in the Department of Foreign Affairs his vision and his insights.

Pak Ali served as Foreign Minister from 1988 to 1999, first under President Suharto and then under President Habibie. It was an eleven-year period that he described as "the best of times and the worst of times for the human race. A time of rapid and fundamental change, of promise and progress, yet also of profound contradictions.

The world was changing and the Western countries were changing the way they regarded the developing world. At the height of the Cold

War, the promotion of democracy and the rule of law was secondary to the global struggle against Communism. But with the thawing of the Cold War, the Western countries lost all their anxieties about the Communist threat. In fact, the political thinker Francis Fukuyama thought that liberal democracy and capitalism had finally and totally triumphed—and so it was the end of history.

There was no more tolerance for Suharto's Pancasila brand of democracy, since it had value only as an instrument against an enemy that was already defeated. Instead of an asset, Suharto became an embarrassment to the West in the post-Cold War situation. And the East Timor issue, which received little attention during the Cold War, became a "pebble in the shoe" of the then Foreign Minister Alatas and every Indonesian diplomat of that time. This was especially so after the so-called Santa Cruz incident in Dili in 1991.

In spite of that huge disadvantage, Minister Alatas persevered in negotiating toward a satisfactory solution to the East Timor issue and would have succeeded if the Habibie administration had not suddenly opted for an immediate referendum on the political status of East Timor. With military repression and abuses fresh in the minds of the East Timorese there was no chance they would vote to stay with Indonesia. What followed was a fiasco in which massive human rights violations were committed and the reputation of Indonesia was blackened in the eyes of the international community.

Through all that fiasco, Pak Alatas bravely soldiered on, knowing it would have been a great deal worse if he were not there to give Indonesian diplomacy some measure of rectitude.

In her book, *"Statecraft: Strategies for a Changing World,"* Margaret Thatcher, after stating that Suharto should have retired much earlier, observed wryly: *"there is still something rather nauseating about watching Western countries which were anxious to back him when he was useful, now parrot the slogans of human rights activists, without acknowledging the immense practical benefits which his government brought to the country and indeed to us in the West."*¹

¹ Margaret Thatcher, *Statecraft: Strategies for a Changing World* (New York: HarperCollins, 2002), 125.

She was also critical of the IMF: *"In their anxiety to dislodge him [Suharto], the IMF used the economic crisis that struck Indonesia in 1997 to set terms which they must have known he could not meet and survive. The IMF rescue became, in short, a political rather than a financial operation".*

Kissinger's view was no different: *"Some may argue that the overthrow of the Suharto regime justified the decisions of the IMF (and its sponsors behind the scenes) whatever their motives. But the IMF does not have the political competence to lead political revolutions.."*²

The lesson from the period is that the inability to adapt our domestic situation to the new international environment was Indonesia's undoing. Once a useful ally to the West, it became an embarrassment. That made Indonesian diplomacy a very difficult practice. Of course, Ali Alatas was always there trying to enlighten the world and trying to draw attention to the totality of Indonesia rather than its specific blemishes—but it was not easy.

At the same time internally, after more than 20 years of economic growth, the educated and enlightened middle class of Indonesia began to be politically more active. They now demanded that they be allowed to practice their democratic rights. .

But precisely because the economy was on the rise, the New Order leadership became even more confident to the point of impunity, and remained unaware of the drastically changing international environment. Instead of adopting new policies and adapting to the new international setting, the New Order leadership simply took a business-as-usual attitude.

In the face of the excesses of the New Order, Pak Ali was a mitigating force. He quietly worked for the establishment of the National Human Rights Commission. After successfully organizing a national seminar on human rights, the Department of Foreign Affairs in cooperation with the UN Human Rights Commission organized a Regional Seminar on Human Rights for Asia and the Pacific.

The seminar was inaugurated at the Istana Merdeka and in the draft of the Presidential speech a phrase was inserted to the

² Henry Kissinger, *Does America Need Foreign Policy?* (New York: Touchstone, 2002), 224.

effect that it was time for Indonesia to have a National Human Rights Commission. Once that was stated by the President, an interdepartmental group was charged with drafting the presidential decree creating the commission and by 1993 the Suharto Government established the precursor of the current Human Rights Commission that was established by Parliament.

Watershed events in contemporary history attended the tenure of Foreign Minister Ali Alatas. The Cold War ended with the crumbling of the Berlin Wall in 1989, the Warsaw Pact was dissolved and there was a surge of globalization. At that time the world saw the promise of the dawning of a Pacific Era in the 21st century, a promise that collapsed with the devastating Asian crisis of 1997/1998.

Domestically, we all witnessed the sudden and dramatic end of the New Order and President Suharto's leadership, followed by the birth of the hopeful Era of Reform. During those years, I often heard Pak Ali say, "A diplomat's work is never done". That was probably because he was feeling the pressure of intense international scrutiny of what was happening in Indonesia. The issues of human rights, good governance and civic freedom had become the dominant issues in international affairs.

What compounded the situation was the refusal of other agencies of government, especially the military, to share information with the diplomats. They simply said: "You are the diplomat, do diplomacy. It is up to you. We deal with security as we see fit".

Most difficult was the handling of human rights issues in the Human Rights Commission in Geneva. Our missions in Geneva/New York/Western Capitals had the heaviest burden but generally speaking the entire Indonesian diplomatic corps was under great pressure.

In such a situation, the country's diplomat became its first line of defence. We had to fend off many accusations and attacks. Often we did not even have the necessary information to make an intelligent defence of the country's position. But there was always the voice of Pak Ali addressed to the world in defence of Indonesia, and at the same time addressed to the Indonesian establishment, gently pointing out the need for reform and to adapt to the new international situation.

In private conversations, Pak Ali often talked of the difficulties of defending the indefensible and explaining the inexplicable. In that situation, most people would seek refuge in the saying, "My country right or wrong." That had a strong appeal to nationalists whenever Indonesia was under strong criticism.

I came to understand from Pak Ali that it is more reasonable to say: Yes, right or wrong, it is my country. But when it is wrong, let's make it right. And when it is right, let's keep it right! Otherwise, as it is said in our bahasa we will be "kerong-rong".

To my generation of senior diplomats, Pak Ali's speeches and his informal conversations became an important source of guidance. Whether speaking in public or in private, Pak Ali was always clear, articulate and eloquent. His clear thinking, incisive analysis and ability to express his views articulately and in a straightforward manner provided a fine example for career diplomats over the years. He inspired us with his patience, meticulous attention to detail, and ability to foster a healthy team environment under difficult conditions.

Pak Ali always stressed that Indonesian diplomacy should be principled. That means that if one yields, it is on the basis of principle, while always trying to reason with the other side and at the same time keeping an open mind.

The goal is a fair, mutually agreeable outcome. Today they call it a win-win solution. It was Pak Ali's basic view of diplomacy that the highest national interest for all countries in the final analysis is peace. He always emphasized the theme of peace.

He wrote in his book, *"A Voice for a Just Peace"* that *"when a diplomat is negotiating a political settlement, promoting trade and investment, arguing for transfer of technology, proposing for a cultural exchange or even just attending a diplomatic reception, he is putting into place one brick after another for the edifice of peace."*

Pak Ali always described diplomacy as "intricate and demanding". But he mastered its intricacies and was equal to all its demands. He was a great team player: he stressed harmony and the consultative approach. He avoided causing embarrassment.

He was the supreme diplomat, not only because of his skills but because of his qualities as a human being. He was first and foremost a family man. He loved to be with his family. He was not only a devoted husband to his dear wife, but also an affectionate father and grandfather.

As an experienced diplomat, he always respected his opponents in the diplomatic arena. He acknowledged the contributions of his colleagues. He generously shared his knowledge and his skills—he was a teacher to everybody. He took an interest in the welfare of everyone he knew. He was a great diplomat, a true statesman, because he was a great human being.

Jusuf Wanandi: *Bidding Farewell to Ali Alatas*³

[Ali Alatas is the best diplomat that Indonesia has ever had. Being energetic and having great sense of humour with balanced temperament, he is well-versed and has great communication skills. Moreover, he possesses strategic views, and trustworthy—both by friends and foes.

With his excellent diplomatic skills, Alex—his nickname among friends—has always found the way to reach his goals. His skill is acknowledged by other diplomats from various countries. Olara Otunnu, a great diplomat from Africa and the Director of the United Nations Peace Academy, once told me that it was regretful that Ali lost the chance to become the Secretary General of the UN due to the Timor Timur issue that Indonesia was dealing with at that time.

He views that Ali is a figure trusted by the international community because of his excellent diplomatic skills, his mature and balanced personality, so that he would be a model of a successful UN Secretary General who came from the developing world.

A Mexican diplomat, after meeting with Widjojo Nitisastro in Watergate Hotel, Washington, DC, in mid-1970s, told me that Widjojo and Ali Alatas deserved a statue built by developing countries due to

³ This article originally appeared in *Tempo*, Vol. 37 No. 43 (2008)

their merits in the struggle for the interests of developing countries during the Conference for International Economic Cooperation (CIEC) in Paris, which was conceptualised by French President Giscard d'Estaing. Ali was the spearhead of Indonesia and other developing countries when taking position as Indonesia's Permanent Representative in Geneva, whose daily task was to handle issues arising in CIEC at that time. Thanks to Ali and his efforts, the interests of the developing countries were taken into account in the international economy, in particular with regard to the effort to prevent the price fluctuations of commodities originating from developing countries.

Ali Alatas made significant contributions for ASEAN, particularly in the effort to formulate ASEAN's ideology in security, national resilience and regional resilience, which were suggested by Indonesia. He also succeeded in the resolution of the Cambodian conflict by promoting Indonesia's initiative to hold the Jakarta Informal Meeting, which was previously established by Foreign Minister Mochtar Kusumaatmadja, and also by co-chairing the Paris Conference with France.

He continued in the next process of dispute resolution between Hun Sen and Prince Ranaridh in 1997. As the Foreign Minister, he was highly praised for his efforts for the region of Southeast Asia and in ASEAN. Aside from the Cambodian conflict, he contributed to the resolution of the conflict in southern Philippines between Nur Misuari's Moro National Liberation Front and the Philippines government.

After serving as the Foreign Minister, Ali Alatas then served as a member of the Eminent Persons Group (EPG), which was given a mandate by the ASEAN Summit to give recommendations regarding the ASEAN Charter. Unfortunately, the draft containing significant recommendations that was produced by EPG was not taken into account by the ASEAN leaders, and the final product was not as progressive as the original inputs.

More than simply a champion diplomat, Ali was a true patriot and a statesman who is always loyal to the Republic. In have written a few years ago in an article published by the Washington Quarterly that I doubt whether the Republic of Indonesia would be able to defend

its unity with so many ongoing conflicts, such as in Aceh, Moluccas, Papua, and Kalimantan. I remember then that Alex criticised my opinion and said that, no matter what, he believed that Indonesia would maintain its unity.

His patriotism in defending Indonesia's interests was evident in dealing with repercussions of the annexation of East Timor by the Soeharto regime. Adam Malik (and Ali Moertopo) wanted a diplomatic resolution by engaging East Timor into the Indonesian territory with a probation time of eight years before holding a referendum. This was a failed effort due to the policies of Portugal, so that it became a military annexation in November 1975 in the effort to prevent Freitlin's Unilateral Declaration of Independence.

When the Habibie administration decided to hold a referendum for the East Timorese, Ali Alatas was in the midst of negotiation with Portuguese Foreign Minister to arrange for a full autonomy period before referendum is held. Ali was the one mostly disappointed with Habibie's decision, however he stood by the sudden decision.

Ali truly believed in the free and active doctrine of foreign policy, and did his utmost to implement it. This was highly respected by others, including the two superpowers at that time. The conservative US Ambassador for the UN during the 1980s, Jeane Kirkpatrick, acknowledged that Indonesia made significant suggestions when Ali was the Ambassador for the UN. His efforts also contributed to the closer relations between the developing countries and the West, although they still have different policies.

As a diplomat, Ali made significant contributions for the Indonesian Ambassador for the US, Soedjatmoko, in the rehabilitation of Indonesia-US relations at the beginning of the Soeharto administration. He also rendered a service to Adam Malik as the Foreign Minister, even serving as the Chief of Staff when Adam was Vice President.

In the area of international economics, Ali was greatly trusted by the group of technocrats under Widjojo, and in many events, he as the Minister of Foreign Affairs led the coordinating team for Indonesia's economic relations.

In the area of security, he was very close with Benny Moerdani, so that any differences between the Foreign Ministry and the Defence Ministry in particular security issues, for example the Cambodian case, could be resolved well and positively.

Ali Alatas was also a person with advanced thinking and sensitivity in the issue of human rights. He was able to convince Soeharto about the benefits and significance of a Human Rights Committee in Indonesia. They might have had differing opinions with regard to the objectives of the establishment of such committee, but after being established and allowed to develop, the National Committee for Human Rights gained its own rhythm.

When Soeharto served as the Chair of the Non-Aligned Movement in the early 1990s, Ali tried to reform the movement to paying more attention to economic cooperation. Regretfully, such effort was hindered by issues of implementation and sustainability, which have always been the weakness of the movement.

For the Centre for Strategic and International Studies (CSIS), Ali Alatas was even more than all that, because he was a friend and member of the CSIS family. It was a great honour for CSIS that he was willing to serve as a member of the Advisory Board. He took part and shared ideas in hundreds of meetings organised by CSIS, both domestically and internationally. We were always sure that we could rely on him when he promised something. During his time with CSIS, we witnessed another character of Ali Alatas: he was always a hard worker and perfectionist in all of his writings and arguments.

Now he has passed away. He was a friend, a partner in fighting for the interests of Indonesia in international relations, a true patriot whom one could rely on for his contribution and thinking by everyone, including the government, the legislative, the NGOs, the business sector, the academics, and CSIS. We pledge to continue his fight and sacrifice.

Sabam Siagian: *Ali Alatas, a Champion Diplomat*⁴

When I visited Pak Ali Alatas, on a Wednesday afternoon of 3 November 2008 at the Mount Elizabeth Hospital in Singapore, he was sitting down gloomily. He said to me haltingly, "There is nothing more precious in life but personal health..."

The doctors have actually advised that Pak Ali should have been able to get outpatient treatments starting 17 December. However, the sudden heart attack on Thursday, 11 December 2008, was fatal. Indonesia's former foreign minister passed away at the age of 76.

I have known Alex, his nickname, since mid 1950s, when we were students at the Faculty of Law and Social Sciences. He was also studying at the Foreign Service Academy, an educational institution that trains future diplomats for three years. The late Ali Alatas was Indonesia's first foreign minister that started his career path from the bottom. He is regarded to have the natural gift to be a champion diplomat.

The Republic of Indonesia, as the fourth most populated country in the world, faces many difficult problems in promoting its national interests in the international arena. Hence, the role of diplomats becomes significant. "Diplomats" are not to be understood as simply the officials of the Ministry of Foreign Affairs, but also officials based at the Ministry of Finance, Ministry of Trade, Ministry of Research and Science, the Indonesian National Armed Forces, and the National Police. It is, however, true that the professional corps come from the Ministry of Foreign Affairs.

Therefore, the personal figure of Ali Alatas should be regarded as a role model. The following characteristics are prominent of his figure.

The first is his foreign languages ability, including English and French. His educational background at a Dutch-based high school in Jakarta supported his ability, not only in Dutch, but also English, French, and German, which were all taught intensively.

⁴ This article originally appeared in *Suara Pembaruan*, 13 December 2008.

His training at the Foreign Service Academy added to his fluency in those foreign languages, for example, in terms of formulating concepts English. I have seen Pak Ali in several meetings of the United Nations in New York (he has served as Indonesia's Permanent Representative to the United Nations in Geneva and New York), where he was urged by his colleagues, the representatives of partner countries, to take charge in formulating concepts of resolutions that has been agreed upon in principles.

Second, it is important for Indonesian diplomats to master particular issues. This means that one cannot be intellectually lazy. It is normal that one cannot be expected to master all technical issues in defence or international trade, for example. Indonesia should have experts in those issues. However, the principles must be mastered by a diplomat so that he/she is able to promote national interests, both in bilateral and multilateral negotiations.

Third, it is important for Indonesian diplomats to take good care of their stamina and health. I have seldom witnessed Pak Ali burst out in rage although having sat in negotiations for hours. He was always able to act friendly to reporters, for example, and remember their names, without giving confidential information what went on in closed negotiations.

I always remember his wise words that he gave to me when I was serving as the Chief Editor of the Jakarta Post, in April 1991.

His secretary called and conveyed a message that the Foreign Minister requested a meeting. With a bright smile on his face, he told me that the President agreed to appoint me as the Indonesian Ambassador for Australia. He then changed to a more serious nature when he gave me his wise words. He told me that I was the first media person to serve as an Ambassador since Soeharto became president.

He emphasised the importance of being patient, and smart to value the positive aspects of a person while avoiding being angry when coming across negative aspects of a person. "Because people know you are my close friend, you must not fail," he said. As a foreign minister, Pak Ali's office was in Pancasila Building in Pejambon. Every time I am in that historical building, the memory of the April 1991 meeting comes back.

It is my hope that the late Ali Alatas stays as a role model for both the current and future generations of diplomats in promoting national interests in the world arena that has become even more complex with tight competition interests.

Nugroho Wisnumurti: *Ali Alatas – The Statesman and Consummate Diplomat*

On 15 December 2008, ten ASEAN Foreign Ministers gathered at the ASEAN Secretariat building in Jakarta for an ASEAN historic moment - the signing of the monumental document *ASEAN, the ASEAN Charter*. This important event was held without the presence of Ali Alatas, a member of the Eminent Persons Group established by ASEAN Summit to prepare the initial draft of the ASEAN Charter. A towering figure in the region and in the world, Alatas, passed away only four days earlier. The untimely passing away of Pak Ali Alatas—that is how we in Indonesia addressed him—Foreign Minister of Indonesia for eleven years, is a great loss to the nation that he loved and the country that he served so well and for such a long time. It is also a great personal loss to his family and to his many friends and admirers all over the world, including myself.

As a member and leader of the ASEAN Eminent Persons Group mandated to draft the ASEAN Charter, Ali Alatas helped craft the document by drawing up from his experience in ASEAN affairs that dated back to the time when ASEAN was established in Bangkok in 1967 and from his legal expertise. His wisdom, his sharp mind and his diplomatic skills as well as his leadership had distinctly contributed to ASEAN's success in navigating through difficult and challenging times. His ability as a peacemaker has helped ASEAN solve some of the most intricate crises such as the Cambodian conflict (1978-1991) that had led to the rebirth of the Kingdom of Cambodia in 1991.

The invasion of Cambodia by Vietnam in 1978 was viewed by ASEAN as a serious threat to the region's peace and stability. The then Foreign Minister of Indonesia—Mochtar Kusumaatmaja as Chairman of ASEAN, determined to find a solution, brought the

warring parties to the negotiating table by launching what he termed "a cocktail party". In 1986, ASEAN decided to appoint Indonesia as the ASEAN interlocutor in its relations with Vietnam. And in 1987 Foreign Minister Mochtar Kusumaatmadja and Foreign Minister Nguyen Co Thach of Vietnam issued a joint statement expressing their agreement to hold an informal meeting of the warring parties and the other directly concerned parties. The meeting, called the Jakarta Informal Meeting (JiM), took place twice, one in Bogor in 1988 (JiM I) and the other in Jakarta in 1989 (JiM II).

Ali Alatas as the new Foreign Minister of Indonesia chaired JiM II. In the chairing of these informal meetings, Alatas showed his leadership, his wisdom and his diplomatic and negotiating skills that I personally witnessed while assisting him as Director of Legal and Treaties Affairs of the Department of Foreign Affairs. He listened, persuaded and cajoled the warring parties in his efforts to bring their positions closer to each other. The results of JiM I and JiM II were further developed at the Paris International Conference of 1989 and of 1990 that led to the signing of the Final Act of the Conference in 1991.

Pak Alatas also showed his ability as a peacemaker in the way he dealt with a political crisis in Cambodia in July 1997 when Co-Prime Minister Hun Sen sacked Co-Prime Minister Prince Ranaridh. This crisis had put the 1991 Paris Agreement and the result of the general elections in serious danger, and had even triggered sporadic fighting especially in the North Eastern region. Alatas, leading an ASEAN Troika (Indonesia, Thailand and the Philippines), made a frantic shuttle diplomacy covering Phnom Penh, Thailand and Beijing in the context of the so-called "constructive engagement" aimed at ending the crisis. With his deft diplomacy and wisdom, Alatas and the ASEAN Troika in cooperation with Japan with its "Four Pillars Peace Plan" finally led the conflicting parties to agree to resolve their conflict in January 1998.

Aside from helping to resolve the Cambodian conflicts, Foreign Minister Alatas also had on his shoulder the task of helping to resolve the conflict in the Southern Philippines. The conflict was between

the Philippine Government and the Moro National Liberation Front (MNLF) that started in 1970. As a member of the Quadripartite Committee of the OIC (Organization of Islamic Conference) and later as a member and Chairman of the Committee of Six of the OIC, Alatas facilitated meetings between the Philippine Government and the MNLF led by Nur Misuari. After three years of series of meetings, a Final Peace Agreement was signed on 2 September 1996.

Alatas's leadership and negotiating skills had actually been widely recognized much earlier, when he was negotiating on behalf of the Group of 77 (developing countries) with the group of developed countries in the context of North-South dialogue for the establishment of a Common Fund for Commodities (1976-1980). As the spokesman and Chief Negotiator of the Group of 77, and as the Ambassador/Permanent Representative of Indonesia to the UN and Other International Organizations in Geneva, he was accomplishing two tasks at the same time. One task is to coordinate and galvanize a common position of his group on issues being negotiated, which is not an easy job as the Group of 77 is a diverse group.

The other one is to negotiate with the developed countries which, in terms of funding, had a stronger position. With his given negotiating skills, combined with his leadership and wisdom and his mastery of the subjects being negotiated, Alatas managed to tie the knot and an agreement on a Common Fund for Commodities was reached in June 1980. When praised for his achievements, he humbly said, as reported in a Jakarta weekly magazine (*Tempo*, 20-26 February 2007), that he learned to be a negotiator when he was posted in Geneva.

It is almost impossible to make an inventory of all the achievements and contribution of Ali Alatas to his country and to the international community. Surely in addition to what has been mentioned earlier, several other accomplishments deserve mentioning, including his contribution to the work of the United Nations, the Non-Aligned Movement, the Group of 77, APEC, ASEM and other achievements in the promotion of bilateral relations with other countries.

His contribution to the negotiations on the complex and intricate high profile question on East Timor should also be mentioned. For

practically 16 years he was directly involved in the negotiations in the so-called Tripartite Dialogue—UN Secretary-General, Indonesia and Portugal—that began in 1983 for the purpose of finding a just, comprehensive and internationally acceptable solution to the question of East Timor. It was quite a challenge for Alatas, as the negotiations went through with numerous ups and downs and even temporary suspension.

The negotiations were so complex as he had to deal not only with Portugal, but also with international pressure and domestic situation where the Government policy formulated in Jakarta often failed to be implemented in the Province of East Timor, resulting in wide gaps between the national strategy and diplomacy to find a settlement and the real situation on the ground. Nevertheless, Alatas as always prevailed and finally a settlement was reached through a referendum that led to the independence of East Timor.

I had the privilege of working with this Foreign Minister for many years. It was a highly rewarding experience to serve under such a world-renowned statesman over those many years. I have benefitted from his wisdom, his tact, his brilliant mind and his leadership. I witnessed how his towering personality commanded great respect from his counterparts and his peers. And yet, in the eyes and heart of his subordinates like me he was a humble person who always showed respect for others regardless of their rank or social status.

I have assisted Foreign Minister Alatas in different capacities in the Department of Foreign Affairs on issues like East Timor, human rights, disarmament and the law of the sea, as well as on regional and bilateral issues. I could not help noticing one of his exemplary qualities as a leader: his consistent open-mindedness for ideas, opinions and policy recommendations that were offered to him.

I had the privilege of assisting him in the negotiations in the Tripartite Dialogue to find a just, comprehensive and internationally acceptable settlement of the situation in East Timor, as Ambassador/Permanent Representative of Indonesia to the United Nations and later as Director-General for Political Affairs, Department of Foreign Affairs.

Over the years when I assisted Pak Alatas in dealing with the question of East Timor, I constantly benefited from his readiness to listen attentively and patiently to my points of views and arguments on crucial and sometimes sensitive issues before he made a decision on the matter. Even if he eventually took a decision that was not what I had proposed, with his convincing arguments and explanation, I had never hesitated to support his decision once it was made.

Pak Alatas was a man of integrity and courage. He always made sure that any specific foreign policy objective was pursued and implemented with firmness, determination and conviction. But, being a true diplomat, he always listened to the views of his counterparts and considered the interests they were representing, while he pursued the national interests of Indonesia in its constitutionally mandated quest for international and regional peace, security and prosperity.

He was really a consensus builder. There were many episodes that bore witness to this quality of his. I witnessed one up close when Pak Alatas chaired an ASEAN Ministerial Meeting in Manila in the 1997. At the working dinner normally scheduled the night before an official meeting, the then Foreign Minister of Thailand, Surin Pitsuwan, now the Secretary-General of ASEAN, proposed that ASEAN review the cardinal principle of non-interference in the domestic affairs of another State, which was and until today strongly held by ASEAN.

The proposal of softening or weakening the principle of non-interference prompted a heated debate during that informal dinner. Most of the other ASEAN Foreign Ministers rejected it outright. When the hour was late and the debate continued its course, Foreign Minister Alatas tried to reconcile the opposing views by suggesting that ASEAN should not decide to weaken or abandon the principle of non-interference, and that ASEAN should instead adopt an approach or mechanism he termed "enhanced interaction," which would allow ASEAN to get involved in helping any member country solve its internal conflict, with the consent of its government. Pak Alatas's suggestion was immediately approved by all of the ASEAN Foreign Ministers. It certainly was a timely solution that made sense to everyone present in that dinner gathering.

Pak Alatas is widely known as a soft-spoken person, eloquent, measured and very precise in choosing his words when expressing his opinion. He had the ability to keep a cool head in the midst of the toughest negotiations. I witnessed only very few instances where he apparently thought it necessary to express his anger and impatience to a counterpart or to a delegate in an international conference—and he did it without completely losing his composure.

Another impeccable character of Pak Alatas that should be noted is his loyalty to the leadership, whether it was President Soeharto or President Habibie under whom he was serving. One case in point is the decision of President Habibie to allow a referendum in East Timor, thus risking the loss of East Timor—a total reversal of Indonesia's long-held position of defending the integration of East Timor. Being quite aware of the ideas and conviction of Pak Alatas on how to best resolve the question of East Timor, namely through the granting of a wide-ranging autonomy to East Timor (which was actually originally the official position endorsed by President Habibie), I knew that Pak Alatas was very disappointed and greatly saddened. Yet, he apparently decided that it was his duty to pursue to the fullest extent the implementation of President Habibie's decision, ignoring his own sentiments.

I shall remember Pak Alatas as a true statesman, consummate diplomat and a great person.

Ed Masters: *Ali Alatas – 1932-2008*⁵

Indonesia has lost a world-renowned statesman, the United States has lost a good friend, and USINDO has lost a staunch supporter and dear colleague. Ali Alatas passed away in Singapore following a heart attack at the age of 76.

Allene and I first met Alex (as we called him) and Jun in the fall of 1964. He was serving as press spokesman and then Director of Information and Culture in the Foreign Ministry at a difficult time when

⁵ This article originally appeared in *The Jakarta Post*, 19 December 2008.

Indonesia's relations with many nations, including the United States, were strained. But even then his guiding principle was clear. He was committed to working for greater international understanding and a reduction in world tensions and economic disparities.

Alex and Jun were tremendously popular among all elements of the disparate diplomatic community in Jakarta in the 1960s. They entertained frequently and graciously, often mixing up guest lists to include diplomats with quite different views—and sometimes diplomats who were not supposed to recognize each other's existence. I remember a boating party at which we found ourselves trapped on a small boat with a Cuban couple. It was impossible not to talk and we found common interests. When I returned to Washington in 1968 as State Department Director for Indonesian Affairs, Alex was already there as Ambassador Koko Sudjatmoko's political counsellor and once again he strongly supported moves to strengthen the bilateral relationship.

Alex carried this ability to build bridges and bring diverse views together onto the wide international stage as Indonesia's representative to the UN agencies in Geneva, Permanent Representative to the United Nations in New York, and Foreign Minister for twelve years (1987-99). Many foreign leaders supported him for the position of UN Secretary General but the "stone in the shoe," as he put it, of East Timor made that final achievement impossible. This was regrettable, for he had worked long and hard but unsuccessfully within the Indonesian government for autonomy for East Timor and a better life for the people.

He played important roles in bringing peace to Cambodia in 1991, to the southern Philippines in 1996 and to easing tensions in Burma. In "retirement" he served as a UN Special Envoy, a member of the ASEAN Eminent Persons Group charged with charting new directions for the organization, and Chairman of President Yudhoyono's Presidential Advisory Council.

Some years ago I asked him whether he would join former Secretary of State George Shultz as Honorary Chairman of the USINDO Board of Advisors. He readily agreed, for he had long felt that, while he did

not always agree with US policies, the two nations played important world roles and needed better understanding. He shared his views on a number of occasions with the USINDO community and gave us invaluable guidance. He had to resign his USINDO position when he joined the President's Advisory Council but was always available to us. We shall greatly miss his wise counsel, steady good humour and most of all his friendship. Going to Jakarta will never be the same.

IJEPa: THE IMPLEMENTATION ROAD AHEAD

Bob Widyahartono

INTRODUCTION

Japan, as the only highly industrialised country in Asia, has played since the 1970s and still plays a pivotal role in Indonesia's economic development in terms of trade, FDI (Foreign Direct Investment), transfer of technology and managerial know-how, and ODA (Official Development Assistance). Japan and Indonesia have a long friendly bilateral relationship which is shown by the frequent visits of high-level officials and parliament members between both countries. Japan and Indonesia share such basic values as freedom, democracy, human rights and rule of law.

Japan views Asia as an important market. The newly industrialising Asian economies have successfully transformed themselves from import-substitution to export-oriented activities. Indonesia joined the process in 1990s, despite setbacks and stagnation in the 1997-1998 crisis years and some years after recovery into the 21st century. In the trade sector, Japan is Indonesia's leading partner. Indonesia exports to Japan in 2007 totaled US\$23.6 billion, while imports from Japan amounted to US\$6.5 billion.

According to BKPM (The Indonesian Investment Coordinating Board), Japan ranks top among the countries investing in Indonesia with accumulated investment of US\$ 18,4 billion (1967-2007). This

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corresponds to 13% of the total. The number of Japanese companies operating in Indonesia is around 1,100. The number of Indonesians employed by Japanese companies totaled more than 315,000.¹

Japan's ODA to Indonesia in 2005 amounted to US\$ 971.million. Japan's ODA strategy to Indonesia (adopted in November 2004, Indonesia and Japan, Strategic Partners for Peaceful and Prosperous Future, Embassy of Japan in Indonesia, August 2007) consists of three pillars: 1) to support the achievement of sustainable development, through economic growth led by private sectors; 2) to support the building of a democratic and just society; and, 3) to support the building of a peaceful and stable nation.

They are also aimed at ensuring win-win outcomes in the sense of increasing technological capacity, helping meet Japanese market standards to ensure real market access, increasing SME (small and medium enterprises) capacity building, and simultaneously improving labor knowledge as well as skills. Mere expectations do not produce positive results. The main purpose of this article is to examine the elements that would be the key to successful implementation of the Indonesia-Japan Economic Partnership Agreement (IJEPA).

THE PROCESS TO IJEPA

Since 1970s Japan is the only highly industrialised country in Asia and her international role has three main components: international trade, Foreign Direct Investment (FDI) and Official Development Assistance (ODA). Technological transfer and managerial know-how transfer are included in their FDI and ODA. As an economic superpower, Japan is expected to make an important contribution to the world in general and Asia in particular. In turn, Japan views Asia as an important market, and a 'detour production base' that serves to alleviate friction between Japan and the West.²

Indonesian leading business circles associated with Kadin Indonesia (The Indonesian Chamber of Commerce and Industry) and

¹ Data from Badan Koordinasi Penanaman Modal (BKPM)/Investment Coordinating Agency. 2007.

² Lim, Hua Sing. *Japan's Role in Asia*. (Singapore: Times Academic Press, 1999)

several experts express their hopes that the signing of the Economic Partnership Agreement (EPA) will effectively promote the liberalisation and facilitation of trade and investment between the two countries, if implemented effectively as well as efficiently. The dynamic effect on both countries will come from the establishment of a reciprocal economic partnership in various fields on a 'win-win basis'.

In December 2002, Japan's Ministry of Economy, Trade and Industry (METI), in a document entitled "Promotion of Economic Partnership", describes the basic structure of Japan's external economic policy as follows:

Multi-layered Approach

Japan is promoting EPAs with closely related countries and regions in the economic sense, as well as working toward the conclusion of the WTO round for establishing global rules. To Japan, the WTO is an essential foundation for a free trading system. On regional cooperation, Japan wants to strengthening ties with selected countries and regions. While on bilateral cooperation, Japan is moving towards enhancing more broad-ranging ties (e.g. Japan-Singapore, Japan-Mexico, Japan-Korea etc).

Japanese Policy to Strengthen Economic Partnership

The basic concept of going forward strategically is to maximise benefit for Japan as a whole, by taking into consideration the benefits of EPA to Japan's entire economy,, the importance for Japan's external policy in geopolitical view, and strengthening the situation of international negotiations, while taking into considerations the circumstances of the other country/economy.

In November 2004, on the sidelines of the APEC Summit, President Susilo Bambang Yudhoyono conducted a meeting with Prime Minister Shinzo Abe, and both agreed to further explore the possibility of creating an Economic Partnership Agreement (EPA). As a result of this initiative, in December 2004 Mari Pangestu, Minister of Trade of Indonesia met with her Japanese counterpart. This was followed by six rounds of the Joint Study, from July 2005 until November 2006.

On 24 January 2006, Mari Pangestu elaborated the basic view on IJEPA³, stressing the important timing of revitalising bilateral relations. This was due to a recognition of the changes and reforms that have been happening in Indonesia, in response to global and regional developments as well as advances on the bilateral front, e.g., the progress achieved by High Level Joint Investment Forum based on the Japan-Indonesia Strategic Investment Action Plan (SIAP).

EPA is conceived of as comprehensive and strategic, and will be most important vehicle to accelerate bilateral trade and investment from Japan to Indonesia. This agreement will be comprehensive in scope, to cover trade in goods, investment services, movement of natural persons, customs procedure, IPR, and competition policy, and most importantly, economic and technical cooperation to promote capacity building to increase technological capacity, assistance to meet standards of the Japanese market, increase SMEs capability, and improve labor skills, in order to ensure win-win outcome of the EPA.

On 24 November 2006, both chief negotiators, Soemadi Broto-diningrat and Mitoji Yabunaka, signed a record of discussions. In June 2007 a wrap-up meetings was held to finalise the IJEPA to be signed by President Susilo Bambang Yudhoyono and Premier Shinzo Abe on 20 August 2007.

Earlier, in January 2007, PM Abe in Cebu, Philippines announced the so-called Japan's Initiatives for East Asia Cooperation, stipulating among others "The Asian Gateway Initiative" as the basic strategy for the formulation of IJEPA, which is based on the following concepts:

1. Towards an Open Japan, namely to make Japan a country where people from Asia and the rest of the world want to visit, study and live ;
2. Working together towards an Open Asia, namely to maintain and further deepen an open regional order with an emphasis on the economy ;

³ Pangestu, Mari "EPA, Towards a Comprehensive and Strategic Economic Partnership -Indonesia and Japan", speech at IJEPA Meeting, 24 January 2006. Available at <http://www.asean.or.jp/invest/archive/speech/fy05indonesia/jan06/mari.pdf>

3. Respect for a diverse Asia, namely to establish relations of mutual understanding and trust while respecting the region's diversity.

KEY ELEMENTS OF IJEPA

In August 2007, The Embassy of Japan in Indonesia published a comprehensive document *"Indonesia and Japan: Strategic Partners for Peaceful and Prosperous Future"*. This document for the first time revealed to the public the major elements of the EPA.

Trade in Goods

Recognising the desirability of increasing liberalisation of trade barriers the two countries, both sides will eliminate or reduce tariffs comprehensively. Major commitments by both sides cover agriculture, forestry- and fishery sector and industrial sector, which would contribute to the expansion of trade and other trade-related activities between the two countries. Both sides will also cooperate in comprehensive capacity-building focusing on enhancing competitiveness of Indonesia in the above mentioned sectors.

Trade in Services

Both sides will make commitments in various sectors that include professional/business, communication, construction, distribution, educational, financial, health related and social, tourism and travel related, transport services.

Customs Procedures

Both sides will promote information exchange and cooperation for the purpose of facilitating trade through simplification and harmonisation of customs procedures and ensuring effective enforcement.

Investment

The agreement will provide a framework for further expansion and facilitation of cross-border investment between the two countries through commitments on national treatment, most-favoured-nation-

on treatment, prohibition of performance requirements, dispute settlement between state and investor, and enhanced protection of investors and investment.

Movement of People

Both sides will provide a framework for facilitating movement of people in various categories including short-term business visitors, intra-corporate transferees, investors and people who are engaged in professional services. In the same context, both sides will also establish a scheme of acceptance for nurses and careworkers from Indonesia to Japan.

In addition, both countries share a common view that the movement of people involved in business activities should be encouraged. Based on the past bilateral consultations, Indonesia reaffirms its commitment to facilitate and simplify procedures concerning Japanese business activities, in accordance with the relevant laws and regulations of Indonesia.

Energy and Mineral Resources

Given the strategic significance of energy and mineral resources for sustainable economic growth in this region, both sides will ensure close coordination to promote and facilitate investments in this sector, and to contribute to enhancing security of supply of energy and mineral resources. To this end, both sides will strengthen a policy dialogue and cooperation.

Intellectual Property

Both sides will ensure adequate and effective protection of intellectual property, promote efficiency and transparency in administration of intellectual property protection system, and provide for measures for enforcement of intellectual property rights against infringement, counterfeiting and piracy. The JIEPA will provide the basis for both sides to cooperate in the field of intellectual property.

Government Procurement

The agreement will provide a framework for the exchange of information and a mechanism for the dialogue with the participation of the two governments , the respective private sectors and other relevant organisations.

Competition

Both sides will promote competition by addressing anti-competitive activities and cooperate in strengthening competition policy and implementation of competition laws, in accordance with their respective laws with laws and regulations.

Improvement of Business Environment and Promotion of Business.

The agreement will provide a mechanism for the improvement of business environment and promotion of business confidence , with the participation of the two governments, the respective private sectors and other relevant organisations.

Cooperation

Both sides will promote bilateral cooperation for capacity building in various fields, namely manufacturing industries, agriculture, forestry and fisheries, trade and investment promotion, human resources development, tourism, information and communications technology, financial services, government procurement, environment, with a view to strengthening economic partnership between them. They may also consider other fields of cooperation to be mutually agreed in the future.

THE OUTLOOK OF IJEPA IMPLEMENTATION

Preliminary studies suggest that the benefits from EPA for Indonesia are as follows :

1. Increase in export of 4.7%;
2. Japan will abolish 9,275 tariff items, so that the trade sector could increase to 65 billion dollars in the year 2010;

3. Improvement of commodity and service access in the Japanese market;
4. Increase of Japan's investment in Indonesia;
5. Improvement of competitiveness;
6. Improvement of purchasing power of the Indonesian society.
7. Japan on its part expects the following benefits:
8. Guaranteed raw material supplies for Japanese industry in Indonesia;
9. Transparency of upholding Indonesia's Investment Law;
10. Facilitation of energy supply from Indonesia.

Japan is the number one investor in Indonesia. It contributes to job creation, technology transfer and export capability-building in Indonesia. In line with the economic ties, a joint effort by governments and private sectors of both countries has contributed to the improvement of the investment climate in Indonesia.

Table 1 Balance of Trade Indonesia-Japan, 2002 - 2008 (million US\$)

Year	Export	Import	Balance Total	
2002	12,045	4,409	+ 7,635	16,454,428
2003	13,603	4,228	+ 9,375	17,832
2004	15,962	6,082	+ 9,881	22,044
2005	18,049	6,906	+11,143	24,955
2006	21,732	5,516	+16,216	27,248
2007	23,632	6,527	+17,106	30,159
2008*	10,423,	10,659	- 235	20,081

Source : Business Indonesia /CBS

*) January-September (very preliminary figures for non oil and gas only).

Tabel 2: Top 15 Export Commodities from Indonesia to Japan, 2005 – 2007

No	SITC	Commodity
1.	034	Fruit, fresh, chilled or frozen
2.	036	Crustacean, Moluscs and aquatic invertebrates
3	037	Fish, crustaceans, moluscs, and other aquatic invertebrates prepared / preserved
4.	071	Coffee and coffee substitutes
5.	231	Natural rubber latex, natural rubber and similar natural gums
6.	248	Woods simply worked/railway sleeper of wood
7.	283	Copper ores and concentrates
8.	248	Nickel ores and concentrates
9.	321	Coal pulverised or not;
10.	334	Petroleum products, refined
11.	574	Polyacetals, polycarbon, primary
12.	634	Veneers,plywood, improved or reconstituted wood worked ;
13.	682	Copper;
14.	752	Automatic data processing machines/ units thereof
15.	763	Sound recorders or reproducers

Source: Business Indonesia from CBS Indonesia

Other important commodities exported to Japan are milk and cream and milk products other than butter or cheese (SITC 022); fish dried salted or in brine, smoked fish (SITC 035); meal and flours of wheat and flour of meslin (SITC 046). Indonesian imports from Japan are shown in Table 3.

Table 3. Top 15 Import Commodies from Japan 2005-2007

No.	SITC	Commodity
1	232	Synthetic rubber latex, synthetic rubber and reclaimed rubber
2.	251	Pulp and waste paper
3	266	Synthetic rubber suitable for spinning;
4.	282	Waste and scrap metal of iron or steel
5.	334	Petroleum products, refined

6	511	Hydrocarbon, nes and their halogeneted nitrated, nitrated derivatives
7	515	Organo-inorganic and heterocyclic compounds
8	533	Pigments, paints, varnishes and related materials
9	554	Soap, cleansing and polishing preparations
10	598	Miscellaneous chemical products;
11	625	Rubber tyre, tyre cases, tyre threads, inner tubes and tyre threads
12	663	Mineral manufactures
13	673	Flat rolled products, no clad
14	676	Iron and steel bar, rods, angels,shaped and sections
15	713	Internal combustion piston engines and parts

Source: Business News, from CBS Indonesia

Other important commodities imported from Japan are Cotton (SITC 263), Non-ferrous base metal waste and scrap (SITC 288) ; Soap cleansing and polishing preparations (SITC 554). While the IJEPA is expected to further increase bilateral trade between Indonesia and Japan, it can be argued that the agreement has strategic value in promoting sustained investment from Japan to Indonesia that could contribute to sustained industrial and technological upgrading in Indonesia. Economic and technical cooperation, focusing on capacity building is an integral part of this effort.

JAPAN’S DIRECT INVESTMENT TO INDONESIA

Edward Chen⁴ argued that “It may seem to be common sense today, that export-oriented industrialisation is a better strategy than import substitution.....Import substitution in the form of protecting infant industries behind a tariif wall was therefore the norm of industrialisation strategy. ...Protectionism is usually accompanied by a low interest rate policy for the encouragement of the use of the use of capital and an overvalued exchange rate for the ecouragement of the import of capital goods. All these measures are unfortunately price-distorting and have long-term negative impact on economic

⁴ Edward Chen. *The Asia Model of Economic Development : Policy Implications for the 21st Century.* (Tokyo: Institute of Developing Economies, 2007)

development.” He further described the stages and types of industrialisation as follows:⁵

- (i) Import-substitution 1 (IS1), producing consumer goods ; using protectionist measures to groom infant industries ;
- (ii) Import-substitution 2 (IS2), producing capital goods and consumer durable;
- (iii) Export Orientation 1(EO1), producing light manufactured goods;
- (iv) Export Orientation 2 (EO2) and Export Orientation 2 Complex (EO2-complex) producing technology/capital/knowledge-intensive industries, developing services, especially financial, undergoing technological and economic restructuring .

Since 1980s Indonesia entered the EO1 industrialisation stage and has invited Japanese firms to invest in EO1. As the number one investor in Indonesia, Japan has contributed to job creation, technology transfer and export capability-building in Indonesia. In line with the economic ties, a joint effort of governments and private sectors of both countries has formulated measures to improve the investment climate in Indonesia.

For a long time, trade and direct investment have been treated as substitutes in the sense that the firms either export to a market or invest there. However, it gradually turns out that trade and investment are to a large extent complementary, in the sense that investment across borders promotes the flow of both imports and exports. In most situations FDI from Japan has been trade-promoting.

The majority of FDI from Japan to Indonesia is in the manufacturing sector, contributing to job creation of more than 200.000 workers and had strengthened the industries through gradual technology transfer. FDI from Japan to Indonesia are mostly wholly owned subsidiary and joint venture while licensing, franchising and contract manufacturing

⁵ Ibid.

are not common. The following table provides Japan's FDI to Indonesia since 1995.

Table 4. Japanese Direct investment to Indonesia 1995-2007 (million US \$)

Year	Number of Projects	Amount of Investment
1995	135	3,792
1996	145	7,655
1997	94	5418
1998	78	1331
1999	71	640
2000	93	1,955
2001	100	818
2002	82	519
2003	75	1,254
2004	76	1,689
2005	76	1,176
2006	55	444
2007*	113	618

Source: BKPM

*) December 2007, very preliminary figure.

THE PROSPECT OF JAPANESE FDI INVOLVEMENT IN SELECTED SEZ PROJECTS

Within the EPA scheme Japan's FDIs could be invited to play a greater role in the development of selected Special Economic Zones (SEZs). Mitsuhiro Kagami & Masatsugu (2003) defined industrial agglomeration in four categories:⁶ 1) Clusters where locally specialised items are produced or involving local product districts;

⁶ Mitsuhiro Kagami & Masatsugu Tsuji (Ed.). *Industrial Agglomeration : Facts and Lessons for Developing Countries*. (Tokyo: Institute of Developing Economies/Japan External Trade Organizaion, 2003)

2) Clusters where a large core firm has many subcontracting or parts makers surrounding it or so-called industrial castle-town (*jokamachi*); 3) Clusters in large cities where lots of basic production processes are treated or involving urban processing clusters; and 4) Government-led industrial parks and estates often seen in developing countries.

These industrial clusters have several shared features despite differences according to category. First, there exist strong externalities derived from vertical as well as horizontal transactions through subcontracting and inter-firm cooperation that create 'collective efficiency'. Accumulated knowledge is also shared among firms. Clusters in SEZs will develop the efficiency of transportation and communication costs which are to be calculated. The role of regional government is to facilitate the services needed.

The development of Industrial Zones (IZ) began in the early 1990s. The first half of the 1990s also saw the marketing of IZs by Marubeni, Nisho Iwai and Itochu. Marubeni developed 320 ha site named MM1200, where both EPZ (Export Processing Zones) and IZ were located. Meanwhile, Nisho Iwai began acting as marketing agent for the 790 ha Cikarang IZ in 1992. Itochu also began marketing the massive 1,120 ha Karawang IZ in 1993.

Sumitomo was given permission to establish the East Jakarta Industrial Park in 1989 and sales commenced in 1991 with completion in 1995. Sumitomo's share of investment in the joint venture was 60% and the total area of development was 320 ha. The increase in sales of the IZ can be partially explained by the decision of the Indonesian government in June 1994 to approve 100% foreign subsidiaries, which was effective in marketing the IZ. The development of the IZ created some 30,000 new jobs and approximately US\$2 billion was invested from abroad. Consequently until 1996 out of six trading corporations, five participated in the development of IZs in Indonesia.⁷

The success of SEZ operation in the regions depends on efficient physical infrastructure (highways, ports, electric supply, telecommunications, water supply), institutional and legal systems, tax

⁷ Ibid.

administration, tax holidays, banking and telecommunication services.

In the years ahead as a next step, the feasibility of SEZ (Special Economic Zone) in surrounding area of the provincial capitals—such as Bandung, Semarang, Makassar, Medan, Palembang, Pekanbaru, and Pontianak—could be studied in partnership with several FDIs from Japan.

CONCLUSION

A focus on the future of the implementation of IJEPA in the years ahead would be incomplete if limited solely to the manufacturing industry. The other important areas are: financial networks, human resources development in related industrial network, and supporting industries (intermediate goods) supported by R&D.⁸ There are no short cuts to productive efficiency and the most recent call is for firmness and fairness in governance. Good governance means good management of development, institutional arrangements not only at the central, but also at the regional and sub-regional levels.

Regional Kadin should actively participate in promoting as well as provide professional guidance to the business in the implementation of the IJEPA.

To be successful players, Indonesian companies must develop true capacity. Cross-functional teamwork, focusing on development of several skills such as communication, the art of listening, presenting views; cross-cultural skills to deal with diversity (race, gender, religion, ethnicity, physical attributes); regional and international experience in the ability to interact and speak a second language; team orientation, and building teamwork and the willingness to share knowledge, skill and knowledge with partners.

CEOs are pilots who create the vision for the company's future and will be the keeper of corporate culture by ensuring that the core values are sustained. Indonesia's CEOs and middle management

⁸ Akifumi Kukichi. *Can Asia Recover its Vitality: Impediments to Growth in Asia and The Upgrading of its industrial structures*. (Tokyo: Institute of Developing Economies, 1998)

must have and implement with optimism a new vision based on new human spirit.

In sum, the process of implementation of IJEPA can deliver many benefits by encouraging greater efficiency and productivity to economic activities in Indonesia. This opportunity should not be missed.

PRE-ELECTION POLITICAL DYNAMICS

Arief Priyadi

The New Order era had witnessed the practice of authoritarianism that resulted in the limitation of political parties. Yet, with the rise of political, there arises liberalisation of parties, which was subsequently taken as the symbol of democracy. Elections that have taken place after the reform were participated by a large number of parties. However, the number of parties has not shown the diversity of aspirations and objectives of the public, and only few parties gained significant votes. This reflects that the number of parties does not mean the polarisation of the public but the polarisation of the political elites.

In general, the public are aware that voting means directing the political constellation. Through their votes, the people are certain that the politicians whom they vote for will be able to perform in the political arena to realise the people's aspirations. However, the fact that there are many under-qualified politicians who succeeded in getting into the legislative was the negative excess of democracy that emphasises more on the procedural matters with no attention given to the building of the people's awareness. Meanwhile, there is rising public demand for substantial democracy, which includes real implementation, appreciation of public aspiration, and concrete commitment for democratic governance principles.

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As the 2009 Election grows nearer, there are a number of problems arising, mostly related to campaign advertisements and the decision of the Constitutional Court regarding the requirements for the candidates for parliament, independent presidential candidates and the requirements for presidential candidacy.

On the issue of political advertisements, politicians tend to ignore the substantive matters of democracy. What they have expressed in their means of advertisements have proven that political objectives have been reduced to being simply the matters of packaging self-image and appearance. This ongoing tendency can be witnessed through the frequent activities of self-socialisation by both the candidates and the parties on television, radio, and printed mass media.

In spite of that tendency, the 2009 election still provides the opportunity for new legislators and executors who will truly represent the interests of the people rather than those who only emphasise on their parties' interests. Hence, the decision of the Constitutional Court regarding the majority of votes for the candidates will ensure the fulfilment of the public interests. However, the decree creates several complications.

There is a dilemma between idealism and reality with regard to election, particularly the presidential election. All citizens have the right to run for a public position. However, for an independent candidate to run, they must have real support aside from personal capacity.

POLITICAL ADVERTISEMENT

A brief overview on the current situation shows that there is tight advertising competition between Democratic Party and Gerindra Party. These parties have even financial resources to be able to compete on this matter.¹ In general, the advertisement of political parties convey the same messages, among others: (1) claim of a list of achievements; (2) symbolic narration of political messages; (3) emotional messages, or

¹ AC Nielsen reports that during July to October 2008 Gerindra has spent around IDR 8 billion per month for advertising, while Democratic Party spends around IDR 8.5 billion. See *Kompas* 4 February 2009.

efforts to reach out to urban educated communities; and (4) reaching out using collectivist sentiments and public psychology.

The Democratic Party presents its claims of achievements through the ad "*Berjuang untuk Rakyat*" (Struggling for the People), while Golkar Party presents its claims of achievement through the ad "*Penciptaan Perdamaian*" (Peacemaking), which is prone to public sham. Jusuf Kalla, in his counter-argument, suggests that whoever was involved in policy making may claim such achievements.² Meanwhile, Syamsudin Haris argues that Golkar's claims are not proper as Golkar was the "last passenger" in the cabinet, after President Susilo Bambang Yudhoyono persuaded Vice President Jusuf Kalla to snatch the chair position of Golkar Party in order to disband the coalition between PDIP and Golkar that was formed in 2004.³

Indexed political messages are used by Democratic Party, as it usually conveys data without verbal elaboration. The effectiveness of such strategy is often questioned, as the public are mostly unable to analyse and comprehend indexed information. Meanwhile, political messages conveyed using symbolic narration are preferred by Gerindra Party. Through its series of political advertisements, Gerindra uses a narration to elaborate about the aggravating economic and living condition of the nation in the midst of Indonesia's rich natural resources. Such narration is accompanied with the claims of hope to improve the livelihood of the nation, while arousing the public's nationalism. In sum, Gerindra's symbolic narration centres around the emotional sphere, while Democrat's political messages provide information such as statistical data directed at the urban educated communities.

Both Democratic Party and Gerindra Party are striving to influence the public psychologically through their political messages. Without displaying elements of power or elitism, and through an emphasis on togetherness and collectivism, they seem to have succeeded in transforming the audience so that they sympathise and become

² See Effendi Gazali, *Kompas*, 29 January 2009.

³ *Kompas*, January 2009.

prospective voters for them. The use of “we” concept instead of “I” is also the strategy of Golkar Party and its advertisements since February 2009. Such strategy is regarded as successful in diminishing the elitist and egocentric image of Indonesian politics.

It is important to note that the significance of campaigning may shift from a political competition to capital competition. The more capital one has to fund his/her advertisement, the more they can enjoy the political advantage.

CONSTITUTIONAL COURT RULE NO. 24/PUU-IV/2008

At the end of December 2008, the Constitutional Court decided to replace Article 214 of Law No. 10 (2008) that regulated the selection of legislators must be based on the list sequential number. The old article is considered to be against the constitution. With the new decree, there are of course those who are advantaged and those disadvantaged. Those who welcome the court rule have long felt that the political parties are too oligarchic and tend to establish political dynasties. Moreover, voters are not forced to cast their votes on candidates promoted by the parties in the list.

Meanwhile, those who oppose are cadres of political parties that have gained promotion in the parties’ lists of candidates due to their personal relations with the leaders of the parties or because they are regarded as potential internally but not famous outside of the parties. Moreover, parties also feel disadvantaged due to the possibility of internal competitions among candidates to gain voters.

One of the most exposed resentment against the court rule is related to the concern for the loss of women’s constitutional rights. Some articles of the Act No 10 (2009) regulate this. For example, Article 53 regulates that 30% of the candidates from each party must consist of women, while Article 55 (1) stated that the list must be in sequential order, and 55 (1) regulated that in every 3 candidates in the order, one must be female.⁴

⁴ The same line of affirmative policy is also found in Act No 2 (2008) on Political Parties, especially Verse 5 that states that there has to be at least 30 percent female represented in the central structure of the parties.

Divided opinions emerged in response to this matter. First, party internal mechanism should be made available allowing the party leaders to divide between the vote gain of female and male candidates. Based on Article 218 of Act 2 (2008), party leaders should ensure that all electorates obtain three seats, of which one should be given to the female candidate with the most votes. In this manner, the male candidate with the third number of votes should withdraw.⁵ Second, KPU has the right to make this affirmative ruling without the need for a government regulation in lieu of law.⁶ This opinion is supported by the Minister of Internal Affairs, Mardiyanto, who has left the matter to KPU to issue a regulation to implement the Constitutional Court ruling.⁷

Third, the ruling cannot automatically be the legal basis for KPU to organise the election, and that KPU can only implement the rule if it has become part of law.⁸ Fourth, there is also an opinion expressing dissatisfaction, which mostly comes from candidates. Agung Putri, a candidate for legislative from PDIP, for example, claims that the rule would provoke issues of race, religion, and not to mention money politics.⁹

Until the third week of February 2009, or eight weeks before the legislative election, there is still uncertainty whether the government

⁵ J. Kristiadi, *Kompas*, 27 January 2009. See also, KPU, *Kompas*, 28 January 2009.

⁶ KPU has written to the Court, and said that KPU can make the regulation regarding elected candidates based on Article 214 of Act No. 10 (2008) without the need the wait for a revision of the Act or a government regulation in lieu of law. See *Kompas*, 3 February 2009).

⁷ *Kompas*, 4 February 2009.

⁸ There are two reasons. First, based on Article 20 of the 1945 Constitution, DPR has the authority to make the law. Each law is elaborated by DPR and President to obtain mutual consent. The lawmakers are those elected by the people through elections. Law is a political product; hence in a democratic state, lawmakers are those elected by the people through elections. Elections can be thus regarded as delegating the authority to make law from the people to parties and/or candidates. One authority of the Constitutional Court is to review the law based on the Constitution. The ruling of the Court is not a product of a political process, but a legal review based on the Constitution. Hence, as long as the rulings have not been adopted as part of the law, they are a source of law and not a legal basis for state institutions or citizens to act on. Second, related to the issue of legalities in election, where the Court states that Article 214 of Act No. 10 (2008) is not valid, then KPU, candidates, voters, and other stakeholders of the election do not yet have the same interpretation of what popular vote is and its implication to voting models. The terminology "popular vote" is not found in the Court rule. See Ramlan Surbakti, *Kompas*, 1 Februari 2009.

⁹ *Kompas*, 5 February 2009.

regulation in lieu of law that regulates this matter will be issued. The Minister of Internal Affairs has left the matter to KPU to make the implementing regulation. Meanwhile, during the meeting of the Commission on Legal Matters of the Legislative (DPR) with the Constitutional Court in February 2009, the Chairman of the Court stated that KPU is not allowed to make regulations with the same material regulated in the laws. The Chairman of the Commission also reminded KPU to avoid making such mistake.¹⁰

PRESIDENTIAL CANDIDACY

On the matter of presidential candidacy, the Constitutional Court issued two regulations: one on independent candidates and the other on requirements for candidacy. On 17 February 2009, eight constitutional judges (minus one judge, Haryono, the successor of Jimly Asshiddiqie, who was not present due to having not been sworn in), presented the result of the judicial review on independent presidential candidates. The Court cites Article 6A (2) of the Constitution, which states that candidates for president and vice president are proposed by political parties before the election. If the article is interpreted differently to allow for independent candidates, it means that the Court is required to change the Constitution and thus working outside its capacity.

There are dissenting opinions with regards to this issue coming from three judges, namely Abdul Mukthie Fadjar, Maruarar Siahaan, dan Akil Mochtar. Mukthie Fadjar views that all citizens that fulfil the requirements stated in Article 6 (2) of the Constitution should be given the same access to become a candidate for president or vice president. On the other hand, Maruarar Siahaan dan Akil Mochtar view that Articles 1 (4), 8, 9, and 13 of the Constitution are conditionally unconstitutional. They are unconstitutional if the interpretation disallow independent candidacy. However, they disagree to implement such idea in the 2009 Election as there is not enough time to issue a regulation on the procedure.

¹⁰ *Koran Tempo*, 25 February 2009.

There are also other opinions that suggest that having independent presidential candidates would require amending Article 6 (2) of the 1945 Constitution¹, and that independent candidates must have equal support as candidates from political parties². Although Indonesia uses presidential system, there are some of the president's authorities that require support of DPR, hence the president and vice president must obtain early support during the election.³

On 18 February 2009, the Constitutional Court voted against the judicial review regarding the regulation that presidential candidates must be promoted by parties or coalition of parties with 20% of the total seats in DPR, or 15% of the total popular votes. The Court explained there is no potential that the regulation would create undemocratic election. The ruling also had dissenting opinion from three judges.

CONCLUDING NOTES

All of these pre-election dynamics present us with the following notes. First, candidates for president that are advertised in the mass media are mostly "recycled" figures, whose capability and motivation remain to be questioned. As any other type of advertisements, popularity wins the heart, while the track record of these leaders remains lost in history. In such condition, added with inadequate level of political education of the public, the public is left in the dark casting their votes, hence prone to be victims of political sham.

Second, the rulings of the Constitutional Court basically can eliminate the oligarchic power of party leaders in promoting their candidates for legislative. Moreover, the candidates are now motivated to work hard to gain support and sympathy of the public. However, a question remains in place: Will popular votes guarantee the increase of the legislatures' accountability and quality?

GROWTH TUMBLE IN THE MIDST OF GLOBAL SHRINKING

Fajar B. Hirawan & Widdi Mugijayani

GENERAL OVERVIEW

Indonesia's economy showed uncertainties in 2008. These uncertainties will probably persist throughout 2009 as the global financial crisis continues to threaten the national economy aggravated by the slump in other economies around the world. After the East Asian Financial Crisis in 1997–1998, Indonesia recovered with a stable and resilient economy against both internal and external shocks. The government's objective is not only about economic stability, but also about achieving high rates of growth. The economy slightly continued to escalate and is still on the right track to meet the achievement of the high rates of growth until Q2-2008. Furthermore, the GDP growth reached the highest level by 6.4 percent in the second quarter of 2008. But, the economy started to undergo turbulence in the second semester of 2008, in particular in October 2008, as stock markets worldwide crashed and entered a period of high volatility. Consequently, the economic activities were slowing down because of the global food-crude oil force and the financial crises in the region.

In line with the substantial amount of capital outflow from Indonesia, the exchange rate of Rupiah against the US dollar suffered depreciation with high volatility. During the year 2008, the domestic financial market performance, especially Jakarta Stock Exchange (JSX)

(now Indonesia Stock Exchange (IDX)) fell quite significant up to 50%. Nevertheless, the inflation was mainly stable because of several factors, such as the decrease of fuel and commodity prices, the stable stock of staple foods, especially rice, and the significant decline of imported inflation, that did not affect Indonesia's economy. However, based on the balance of payment (BOP), in 2008, the most sensitive indicator that suffered from the global financial crisis is international trade. Even though Indonesia deserves a surplus trade based on exports growth (y-o-y), it showed a declining fall since September 2008. The issue of state budget responding to the global financial crisis and the fiscal stimulus are still considerably becoming the major issues in the year 2009. Meanwhile, the fuel and gasoline price issue still takes place as a consequence from the unpredicted crude oil price.

ECONOMIC GROWTH

In 2008, Indonesia's economic performance has showed ambiguity and uncertainty. There was a contradiction in the growth performances between the beginning and the end of 2008. Starting with the growth amounted by 6.3% in Q1 2008, the growth fell to a low growth by 5.7% in Q4 2008. This condition will probably take place for the next two years. This is confirmed by the International Monetary Fund (IMF) report that mentioned that the global economic growth in 2009 will only be worth 0.5%. The effects of the global financial crisis, according to some economic experts, will persist around the world and will continue in the medium and the long term. The global financial crisis, which has started in the middle of 2007 and worsened in the middle of 2008, has become an important issue affecting countries around the world.

Regarding the expenditure side, the growth was attributed to the increase in import of goods and services in the first two quarters of 2008 as the government removed the ten percent import tax on some commodities, like soybeans. In the last two quarters of 2008, government consumption became the most significant contributor of growth. It became the main contributor as the government ambitiously spent its money in the areas of development and capital spending in

order to increase public consumption and job creation. Meanwhile, from the production side, the transport and communication sector has accelerated the growth of 2008 by 16–20%. It was followed by the electricity, gas, and water sector by 9 – 12%.

Expenditure Side

The economic indicators gave positive signs in the early 2008, but the world economy was slowing down. Indonesia’s GDP grew by 6.3% in 2007 and another 6.3% in the first quarter of 2008. In the second quarter of 2008, it rose cautiously from 6.3% in the first quarter to 6.4%, albeit decreasing in the third and fourth quarter of 2008 by 5.7%.

Based on the recent decrease in price, especially the decrease of fuel price, private consumption showed steadiness yet low-level growth during 2008. But, it was compensated by the major increase in government consumption, to increase the public consumption and to create jobs, starting in the third quarter of 2008 (see Table 1). Meanwhile, the growth rate on the domestic demand was lingering around 7–8% in 2008. Overall, the GDP growth components in 2008 presented a positive progress compared to 2007.

Table 1. GDP Growth Components: Expenditure Side (2000 price, y-o-y) (in percent)

Items	2007	2008				2008*
		Q1	Q2	Q3	Q4*	
Total Consumption	4.9	5.5	5.5	6.7	6.3	6.0
Private Consumption	5.0	5.7	5.5	5.3	5.0	5.4
Government Consumption	3.9	3.6	5.5	16.9	14.6	10.7
Gross Fixed Capital Formation	9.2	15.6	13.1	12.0	9.9	12.5
Domestic Demand	6.0	8.0	7.4	8.1	7.2	7.7
Export of Goods and Services	8.0	15.5	15.9	14.3	9.4	13.7
Import of Goods and Services	8.9	17.8	16.7	11.9	7.1	13.2
GDP	6.3	6.3	6.4	6.1	5.7	6.1

Source: Bank Indonesia

According to Table 2, the second quarter of 2008 represented an enormous breakdown of the gross fixed capital formation starting in Q1 2008. It went slower descending into the third quarter of 2008. The effect of the subprime crisis has been hanging on to the economy

during 2008. It was reflected in the volume of investment, both domestic and foreign, which was unlikely turned up toward a major rising. But, since the government has raised the nominal interest rate referred as BI rate, the intensity of investment in Indonesia tends to be decelerating and slowing down.

Table 2. Indonesia's Investment Growth, Q1 – Q3 2008 (in percent)

Gross Fixed Capital Formation	2008		
	Q1	Q2	Q3
Construction	8.0	8.1	7.5
Domestic Machines and Equipments	20.9	13.9	12.0
Foreign Machines and Equipments	51.9	32.4	32.8
Transportation Tools, Domestic	8.9	6.4	10.8
Transportation Tools, Foreign	76.4	56.2	32.3
Others, Domestic	-2.4	-0.5	-1.9
Others, Foreign	65.7	43.0	17.8

Source: CEIC Asia database

Production Side

The overview of the production side of Indonesia's GDP showed a dwindling pace during the second quarter and the fourth quarter of 2008 (q-to-q) compared to the same period of 2007. Apparently, the global financial crisis has spread a devastating impact to the mining and quarrying sector that showed a negative growth from fourth quarter of 2007 to the second quarter of 2008. Yet, it still can survive the economy during the third and fourth quarter of 2008 (see Table 3).

The transportation and communication sector showed the decent and rather stable pattern during 2007–2008 and it also posted the highest growth at 20.3% in the first quarter of 2008 due to the annual change. However, it was dwindling in the fourth quarter of 2008 and the rest of the sectors, in the production side, did not show any positive sign in the economy. Nevertheless, GDP growth decreased in the final quarter of 2008.

Table 3. GDP Growth Components: Production Side (2000 price, y-o-y) (in percent)

Items	2007				2008				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*	Total
Agriculture	-1.7	4.7	7.6	3.1	5.9	4.9	2.4	2.3	3.9
Mining and Quarrying	6.2	3.2	1.0	-2.1	-1.8	-0.7	1.6	1.4	0.2
Manufacturing	5.2	5.1	4.5	3.8	4.2	4.0	4.3	3.6	4.0
Electricity, Gas, and Water	8.2	10.2	11.3	11.8	12.6	12.0	10.6	9.4	11.2
Construction	8.4	7.7	8.3	9.9	8.0	8.1	7.5	7.0	7.7
Trade, Hotel, and Restaurant	9.2	7.6	7.9	9.1	7.1	7.7	7.6	7.3	7.4
Transportation & Communication	13.0	12.7	14.1	17.4	20.3	19.6	17.1	16.3	18.3
Financial, Ownership & Business	8.1	7.6	7.6	8.6	8.2	8.7	8.5	6.9	8.1
Services	7.0	7.0	5.2	7.2	5.6	6.5	6.7	6.0	6.2
GDP	6.1	6.4	6.5	6.3	6.3	6.4	6.1	5.7	6.1

Source: Bank Indonesia

Outlook for 2009

Thee picture of Indonesia’s economic growth seems to be gloomy throughout 2009.. It will not be similar with the great achievements that had been made in 2007 until the first semester of 2008. We predict that the economic growth in 2009 will only be worth around 4–5%. Bank Indonesia (BI) made prediction that the economic growth in 2009 will be mainly contributed by the government consumption of 9.5–10%. Then, it will be followed by domestic demand with 6–7.5%. The worst thing that will happen is the significant slump in export growth. It will mostly be caused by the slowing of partner countries’ economic growth, ihe decreasing of the commodity price in the international market, and the limited trade financing.

The prospect of Indonesia’s economic growth will likely depend on consumption. The consumption growth will be stronger, 5–5.5%, compared to the historic value of average consumption growth which is only accounted around 4%. The factors that will possibly boost the consumption in 2009 are private consumption, tax policy, the election of parliament members and president, the government plan to increase the provincial minimum wage and public servants’ salary

MONETARY DEVELOPMENT

The high level of inflation, moderate credit growth, Rupiah’s depreciation, and the bearish stock market were becoming the alarming

indicators of the impact of global recession on Indonesia’s financial market in 2008. In order to anticipate the worse condition in the domestic financial market, Bank Indonesia (BI) implemented some policy actions with the specific objective of maintaining the financial stability, such as the high level of BI rate to control the inflation rate, the increase in the amount of government deposit insurance, and the stock of US dollar currency (liquidity).

Inflation Rate

Inflation rate in 2008 was higher compared to the year 2007, recorded at 11.06 percent. It was lower than public expectation of 12 percent. In addition, it was much higher than Bank Indonesia’s target of 6 percent which was set in the beginning of 2008. The global downward trends of the oil and food commodity prices and the tight liquidity of Rupiah were the main factors that contributed to curbing inflation. Meanwhile, the monetary stock contribution to the inflation rate was not strong enough due to some problems that impeded the inter-bank transaction and the government funds stocked in the banking system.

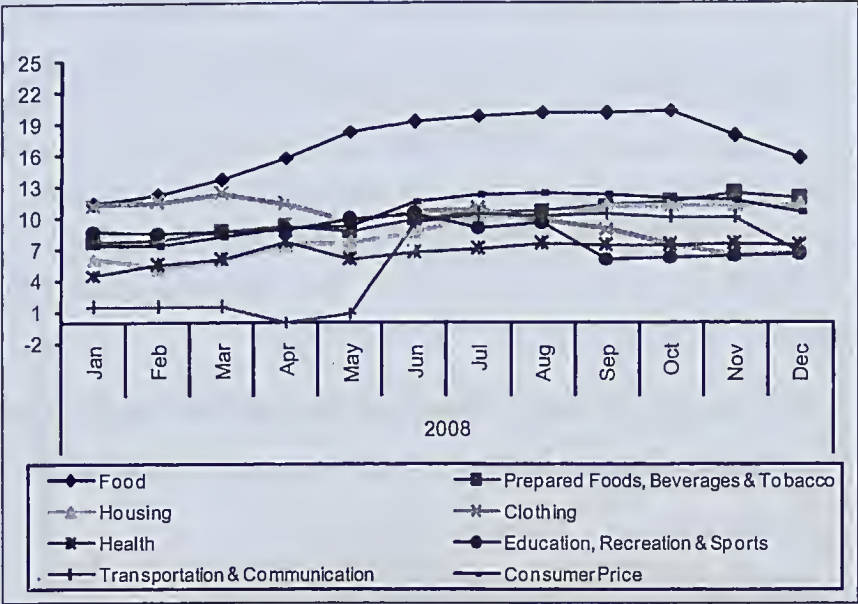
Table 4 shows that the inflation rate was at 0.45% and 0.12% in October and November, while deflation was at 0.04% in December due to the decrease of domestic fuel prices. Nevertheless, it could not compensate the 23% increase of the fuel prices earlier in June, which had boosted the monthly inflation by 2.5%.

Table 4. Contribution of Expenditure Groups to Total Inflation Q4 2008 (2007=100)

	October	November	December
Consumer Price	0.45	0.12	-0.04
Food	0.15	-0.14	0.15
Prepared food, beverage and tobacco	0.13	0.18	0.09
Housing	0.06	0.06	0.13
Clothing	0.05	0.05	0.07
Health	0.02	0.01	0.01
Education, recreation and sports	0.02	0.02	0.01
Transport and communication	0.02	-0.06	-0.05

Source: Central Bureau of Statistics (BI).

Figure 1. Inflation (y-o-y), 2008 (in percent)

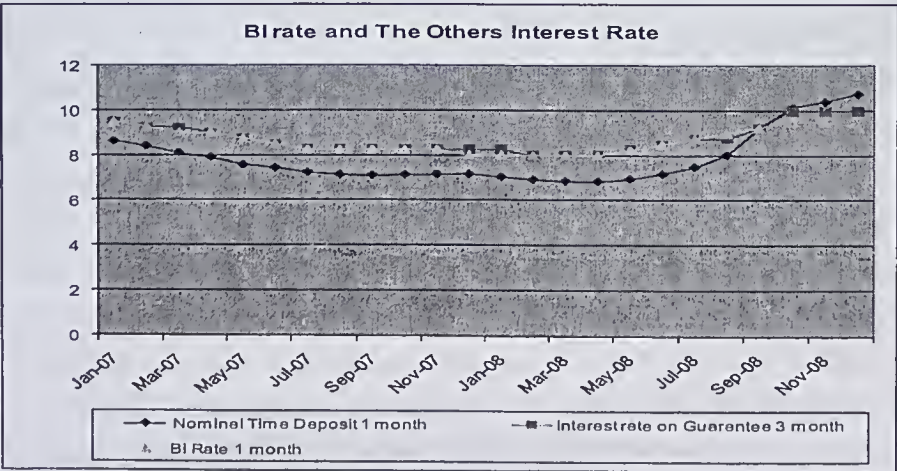


Source: CEIC Asia database

Interest Rate

During 2008, Bank Indonesia continued to maintain the BI rate above 8 percent, before BI cut it in December 2008 when the inflation has been in control. The BI rate was decreased by 25 basis points (bps), to 9.25 percent in

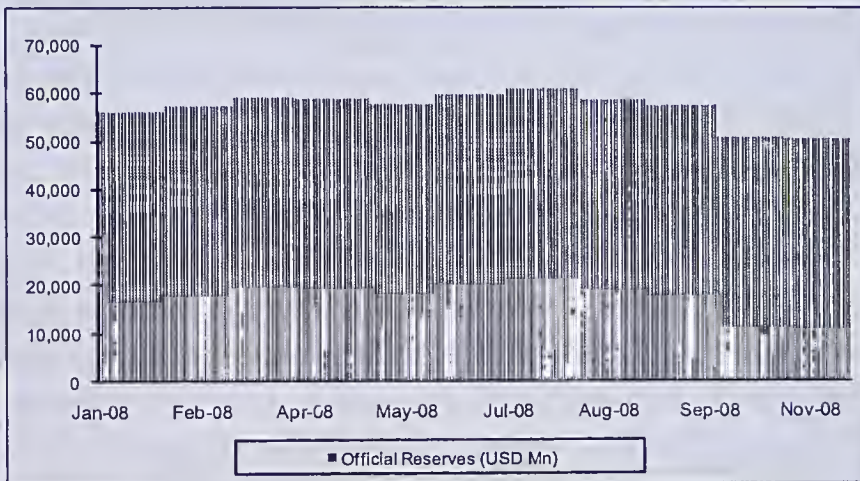
Figure 2. BI Rate and the Other Interest Rate, 2007 – 2008 (in percent)



Source: CEIC Asia Database

December 2008. The movement of the others interest rate, such as nominal time deposit, working capital interest rate, and etc, were in line with BI rate move interest rate policy could secure Indonesia's foreign reserves about USD 51.64 billion in the end of 2008 (see Figure 3), improve the investor's confidence, boost the economic growth, and protect the economy from the threat of recession. It also gives the impression that Bank Indonesia is in cooperation with other central banks around the world in fighting and overcoming the bad impacts of the global financial crisis.

Figure 3. Indonesia's Foreign Reserves (in million USD), 2008



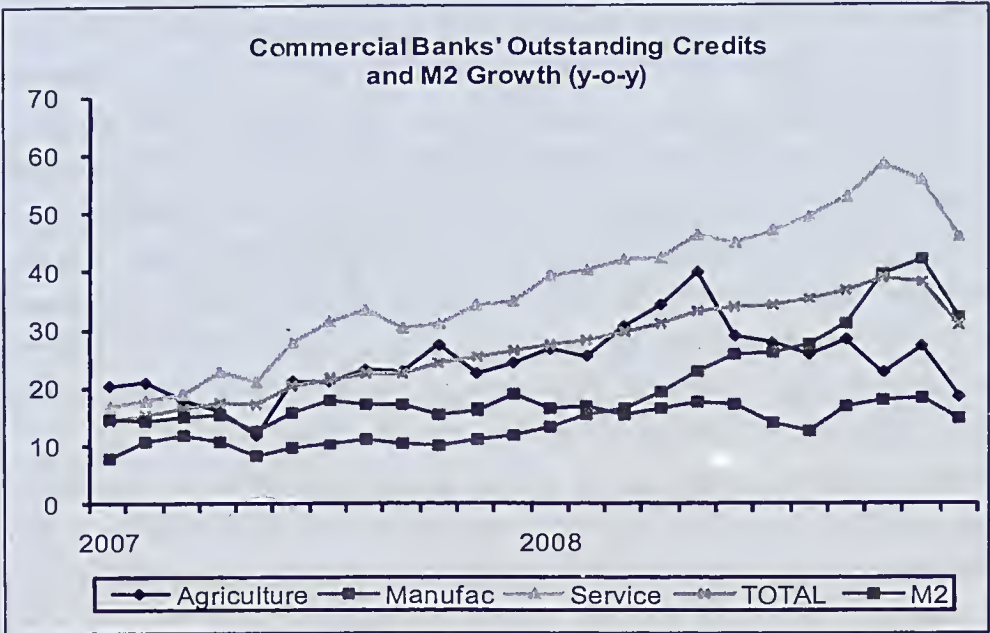
Source: CEIC Asia Database

Credit Performance

In the year 2008, the annual credit growth worth only 30.1 percent. It was lower than the target of 33 percent which was set by the government in the early 2008. In December 2008, the total of commercial banks' credit was valued at IDR1,300 trillion (see Figure 5). It was divided into 52% of working capital credit, 20% of investment credit, and around 28% of consumption credit. By the end of 2008, the credit growth decline occurred in all sectors (agriculture, manufacturing, mining, and services sector) (see Figure 4). This happened because the banks were still worried about domestic business risks. From the business point of view, business people hesitated to expand their

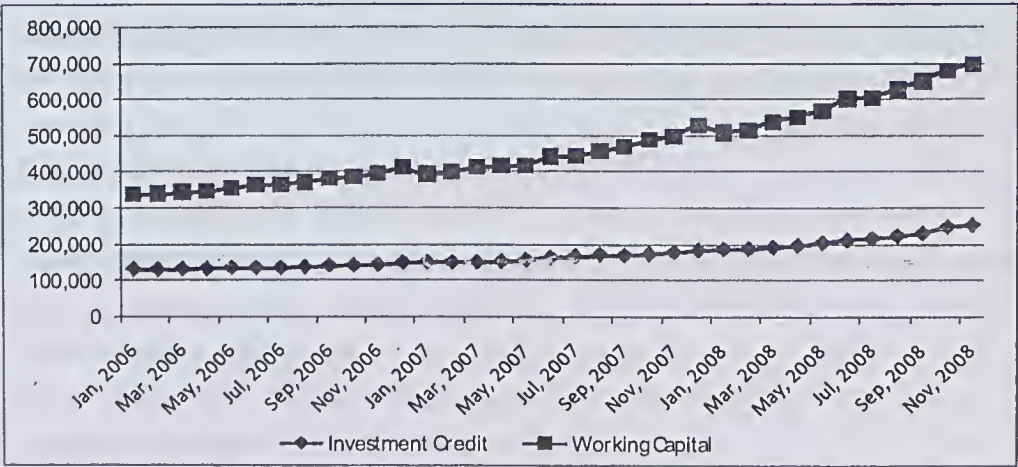
business; they were considering the decrease of purchasing power and export demand.

Figure 4. Commercial Banks' Outstanding Credits and M2 Growth (in percent)



Source: CEIC Database

Figure 5. Commercial Banks' Credit, January 2006 – December 2008 (in billion Rp)



Source: CEIC Database

The Exchange Rate and The Stock Price

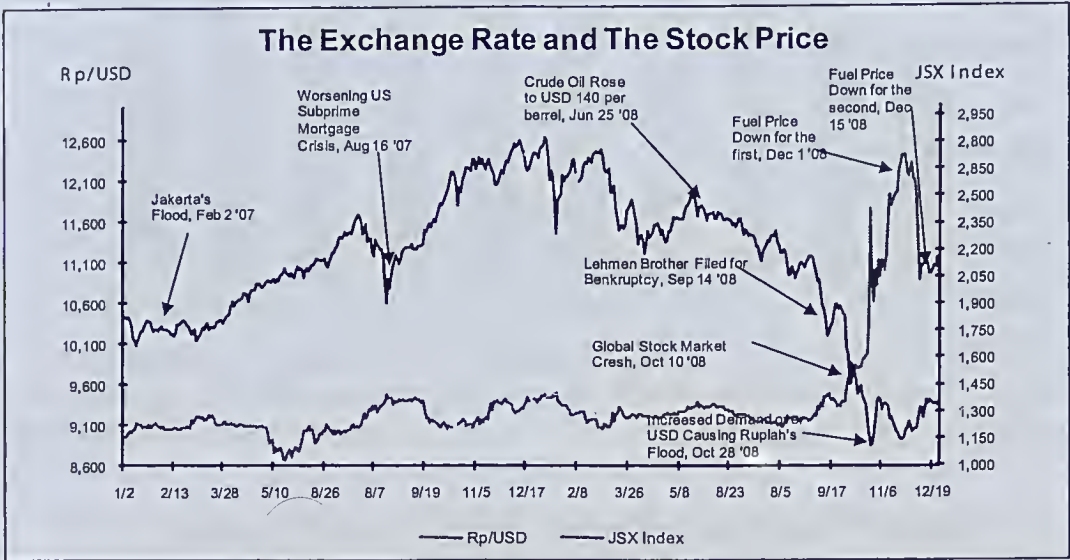
The paradoxical condition took place between the beginning and the end of 2008. Rupiah against the US dollar and Indonesia's composite index seems to be normal in the beginning of 2008. The exchange rate remained stable at IDR 8,800–IDR 9,500 per 1 US dollar from January until August 2008, so did the stock market. It hovered around 2,000–2,600. The unexpected movement on both indicators began in the third quarter of 2008. After the rise of crude oil price and also the accumulation effect of global financial crisis, Indonesia's composite index fell sharply and it reached the lowest level at 1,114 in the one of Indonesia's historic day, Youth Pledge (*Sumpah Pemuda*), 28 October 2008. It was contributed mainly by the negative sentiment of global financial market, because the movement of stock market in line with the trend of regional stock markets given the relatively high foreign exposure of the country's financial market.

Rupiah (IDR) depreciated by an estimated 20% in the fourth quarter of 2008, from IDR 9,219 (in average) in the third quarter to IDR 11,023 (in average) in the fourth quarter. It was touching the lowest level during 2008 by IDR 12,400 per 1 US dollar. The high fluctuation of US dollar and tight liquidity situation were mostly caused by the pressures from deteriorating global financial market and slightly higher US dollar demand from domestic businesses. Nevertheless, the depreciation of Rupiah might become positive, in terms of supporting export, but, it put more downward pressure for the inflation. The capital outflow was expected to be high, given the free capital account regime that Indonesia adopted and the realignment of investors' portfolio structure.

Bank Indonesia and Ministry of Finance promulgated several policy actions, especially policies for ensuring Rupiah's liquidity sufficiency, through increasing the amount of government deposit guarantee, from IDR100 million to IDR2 billion, and increasing the definition of banks' assets that are allowed as collaterals for short-term funding by the Bank Indonesia. Meanwhile, to halt the depreciation of Rupiah, the government introduced the increase of US dollar currency stock or liquidity, including the extension of foreign exchange swap

tenor, the availability of foreign reserved ratio of US dollar, and the abolition of the limitation for the daily balance of short run foreign loans.

Figure 6. The Exchange Rate and the Stock Price, 2007-2008



Source: CEIC Asia database

Outlook for 2009

Generally, in 2008, Indonesia's economy was still in control even though global recession affected most countries in the world. Indonesia's economic condition was relatively better than other countries. Unfortunately, some regulations related to economic improvement were introduced in the same time as the global financial crisis that has already become the major issue and its implications, both lightly and heavily, which spread to almost all aspects of the economic activities.

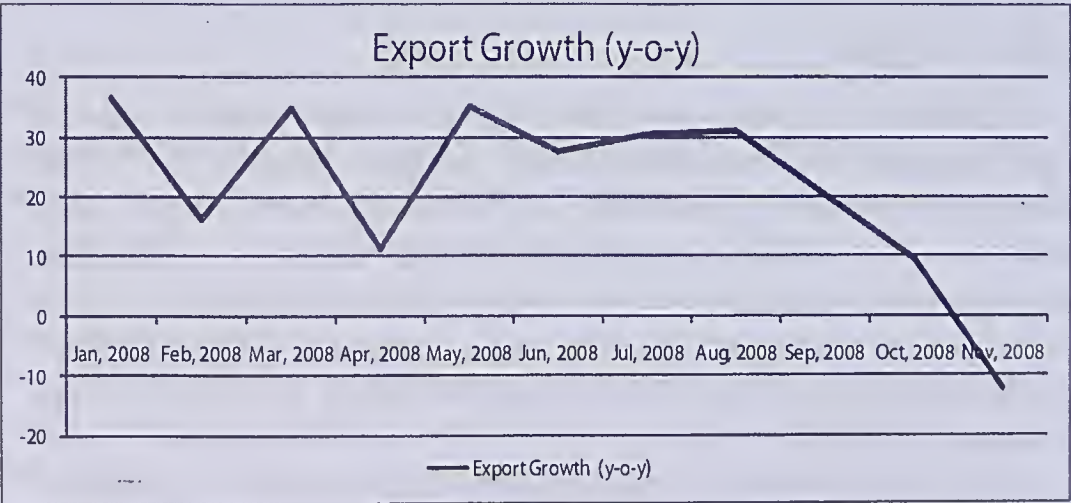
As for 2009, Indonesian economy will be influenced by the global economy. Inflation is not alarming since the global commodities' prices continue to decrease. Lack of liquidity still occurred, so rupiah might not return to their average level which is around IDR9,000 at the beginning of 2008. As a projection, the exchange rate will be around IDR11,000–12,000 per 1 US dollar. Similar to the Rupiah,

Indonesia’s composite index will probably reach a new equilibrium of around 1,350 – 1,450. In addition, it is important to implement the low interest rate policy for boosting the economy when it is facing the global economic recession. In the coming months, Bank Indonesia will likely reduce the BI rate for at least 50 basis points (bps).

BALANCE OF PAYMENT

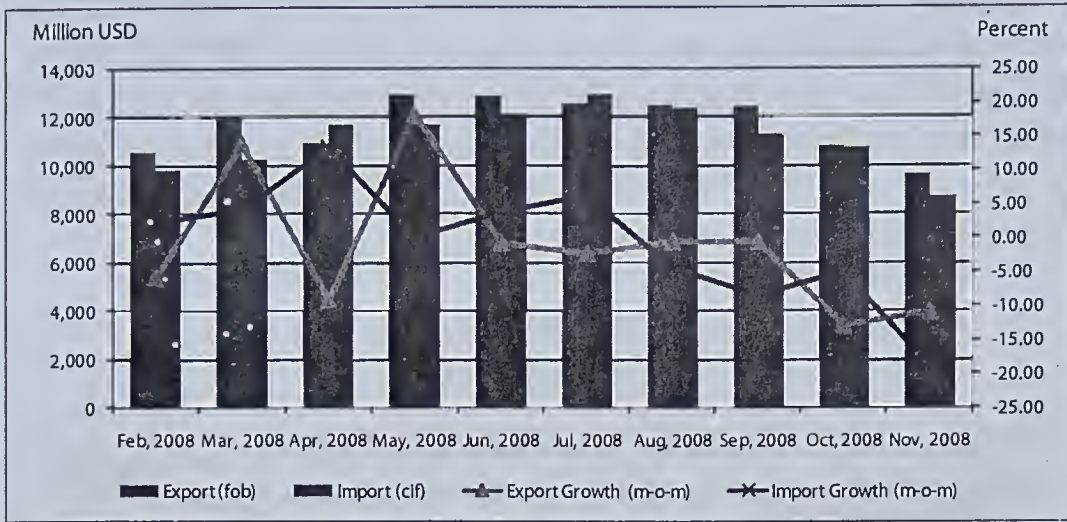
In the recent research about the effects of the global financial crisis, economists are observing some components in the balance of payment (BOP). The findings that are frequently mentioned in those kinds of research are trade and capital flow. It is absolutely the accurate evidence to prove that trade is the main indicator which is most significantly affected by the catastrophic global financial crisis. Export growth fell from 36.57% (y-o-y) in January 2008 to -12.16% in November 2008 (see Figure 7).

Figure 7. Indonesia’s Export Growth (y-o-y), January – November 2008 (in percent)



Source: CEIC Asia database

Figure 8. Trade Performances in Indonesia, February – November 2008



Source: CEIC Asia database

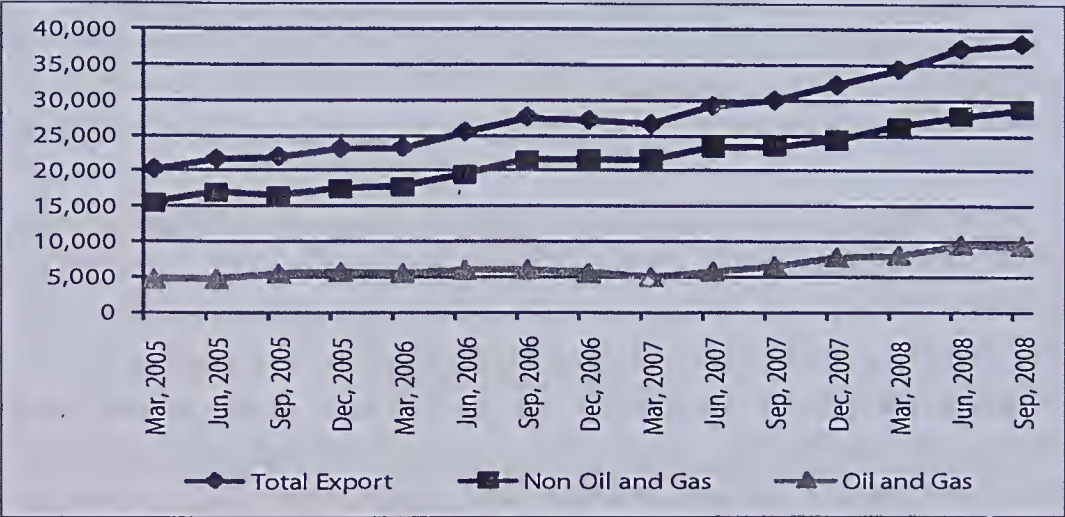
In addition, export and import growth (m-o-m) collapsed to the lowest level at the end of 2008, -12.91% (m-o-m) for export growth in October 2008 and -18.78% (m-o-m) in November 2008 (see Figure 8). This condition is sufficient to give a sketch about the slowing down of Indonesia's economy. In terms of capital flow, both private and government capital flow, were fluctuating. At the beginning of 2008, there were private capital outflow and government capital inflow. The private capital outflow in Q1 2008 was worth USD 3.86 billion. Meanwhile, the government capital inflow was valued at USD 1.89 billion. Then, in Q3 2008, there were private and government capital inflow. Private capital's outflow was changed by USD 3.86 billion to inflow by USD 751 million. In the meantime, the government capital inflow has a twofold decrease from USD 1.89 billion in Q1 2008 to USD 961 million in Q3 2008.

Exports

The movement of the export trend showed that the total export began in 2005 until 2006 that is still in favor with the major macroeconomic indicators that are also reflecting an increase pace

during the period. Entering the first quarter of 2007, the export sector endured at the point slightly above USD 25 billion and then was boosted by the non-oil and gas export sector so it reached USD 30 billion right at the beginning of the third quarter of 2007 (see Figure 9). The oil and gas export since December 2006 does not show any increasing path since the decreased demand of oil and gas commodity all over the world due to the slowing down of the global economy over the accumulation of the global financial crisis.

Figure 9. Indonesia’s Export Trend, Q1 2005 – Q3 2008
(in million USD)



Source: CEIC Asia database

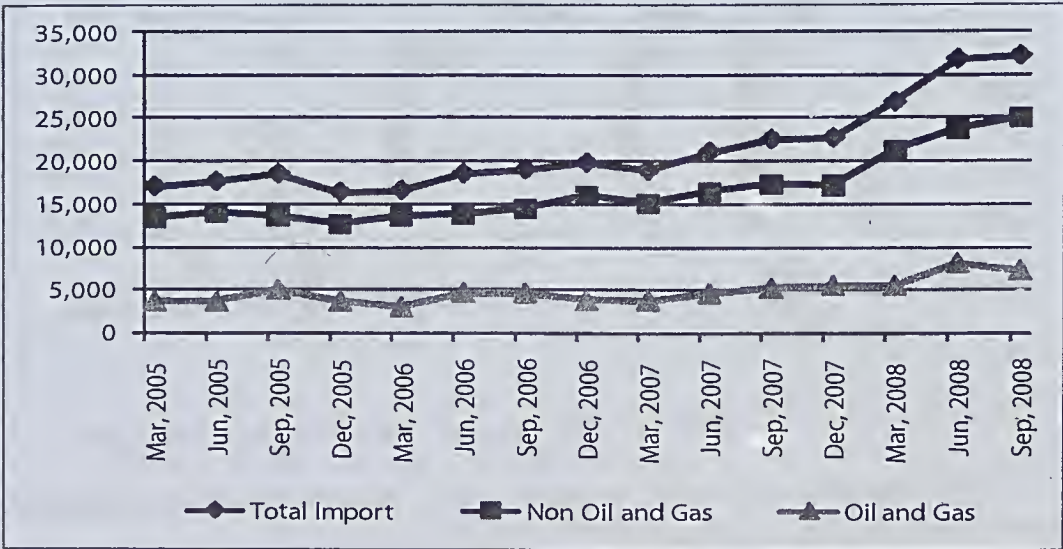
Based on Figure 9, the oil and gas export showed the increasing trend from Q1 to Q2 2008 as well as the non-oil and gas export and the total export. In the third quarter of 2008, the oil and gas export was unexpectedly declining along with the decrease of global demand and the slowing down of the global economy. The non-oil and gas export went up at a snail’s pace as well as the total export.

Imports

The import trend indicates a relatively small decrease of economic activities, showing the gradual increasing rate of non oil and gas

imported goods that include consumption and capital goods. The major incline during the period of December 2007 to June 2008 is at 50%, and then, it goes into a stable movement entering the fourth quarter of 2008. Meanwhile, the oil and gas import has been in a lower level during the period 2005–2008 around USD 5 billion, that indicates the domestic demand of oil and gas commodity is decreasing due to the sufficient domestic production capability.

Figure 10. Indonesia’s Import Trend, Q1 2005 – Q3 2008
(in million USD)



Source: CEIC Asia database

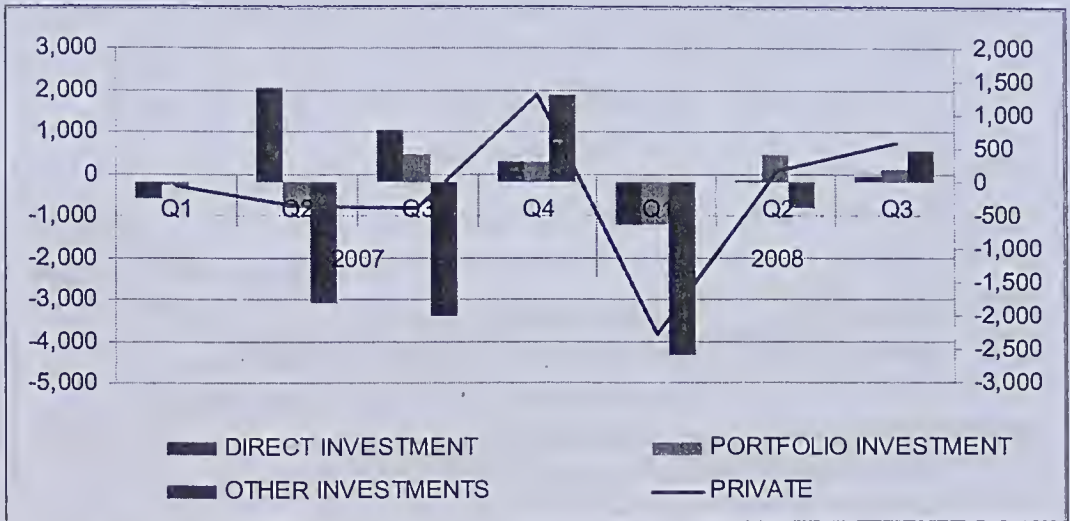
According to Figure 10, the oil and gas import showed the increasing trend from Q1 2008 to Q2 2008 as well as the non oil and gas import. In the third quarter of 2008, the oil and gas import was suddenly declining in line with the decrease of domestic demand. Meanwhile, the non oil and gas import grew slightly as well as the total import.

Capital Flow

After looking at trade, it is also necessary to overlook Indonesia’s capital flow, both private and government. The private capital flow

is formed by three main investments. There are direct, portfolio, and other investment. From the direct investment, based on Figure 11, foreign direct investment (FDI) tends to increase since Q1 2008. But, the trend is not as convincing as the previous year, 2007.

**Figure 11. Private's Capital Flow in Indonesia, Q1 2007 – Q3 2008
(in million USD)**



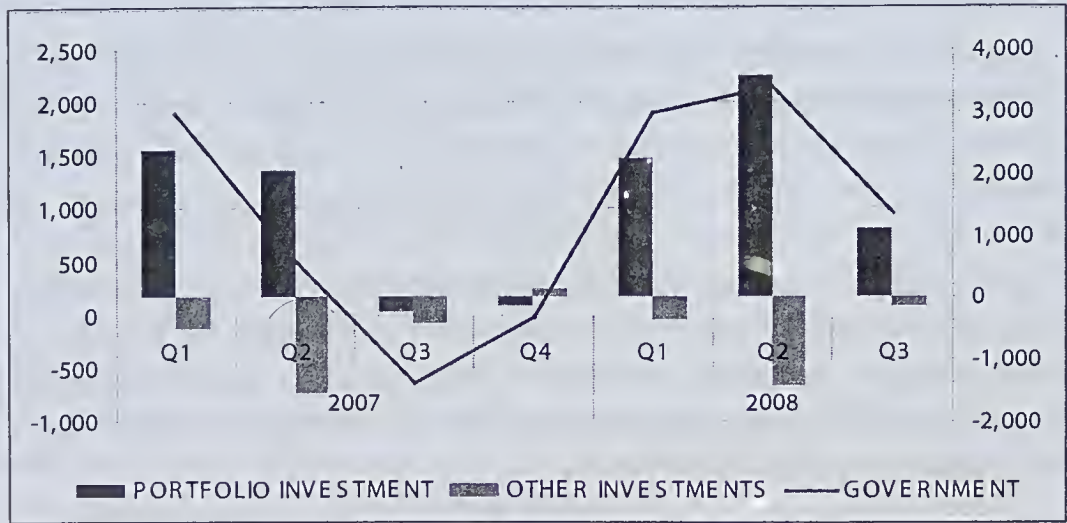
Source: Bank Indonesia

In the beginning of 2008, private capital flow was driven by other investment outflow around USD 4 billion. In the second quarter of 2008, there was a capital inflow from the portfolio investment worth an estimated USD 450 million and the rest were private capital outflow, both direct investment and other investments. In addition, in the third quarter of 2008, all types of investments were classified as private capital inflow (see Figure 11).

Meanwhile, the government's capital flow is consistently driven by the portfolio investment. The debt securities reached the highest level in Q2 2008 by USD 3.57 billion. It increased by USD 1.53 billion compared to Q2 2007. On the other side, loans are still considerably supporting the government's capital from other investment perspective. The loans seem to be always volatile but looking further into the loans trend since 2007, the government is not likely to rely

on loans. In 2008, project aid led the main contributor of government loans with the amount around USD 400 – 550 million. Furthermore, the program and project aid in the last quarter of 2008 are possibly increasing as many donor institutions, like ADB, World Bank, JBIC, and etc, liquid their money to Indonesia’s government at the end of the year.

Figure 12. Government’s Capital Flow in Indonesia, Q1 2007 – Q3 2008 (in million USD)



Source: Bank Indonesia

Outlook for 2009

As the economy has slowed down since the global financial crisis took place in mid 2007 and became worse in mid 2008, the BOP prospect for 2009 will likely stay the same, and the murky condition is still going to haunt the BOP performance in Indonesia. The decreasing trend of export, which has taken place since Q4 2008, will probably continue until 2009. The declining commodity prices and the slowing down of the economy will still become the main causes of the losing pace of export growth. Meanwhile, the import performance in 2009 is also influenced by the decrease of domestic demand.

Regarding capital flow, in 2009 the composition of investments will probably remain the same with the previous years. Private

capital flow is still mainly attributed by both direct investment and portfolio investment. Meanwhile, from the government view, portfolio investment will considerably become the most attractive for the investors. Furthermore, in facilitating the BOP recovery and also to support the real sector in Indonesia, the government and BI should strengthen the coordination, especially for mixing or synergizing the fiscal plus monetary policy.

OTHER ISSUES

Gasoline Prices Go Down

Price of gasoline or fuel will go down again early this year, following the raging decline in international gasoline prices during last year's second semester. The government started to lower gasoline prices on 1 December 2008 for both premium and solar gasoline. At the end of the year, the price of premium and solar gasoline was down from Rp 6,000/litre to Rp 5,000/litre and from Rp 5,500/litre to Rp 4,800/litre, respectively. Currently, the government was assessing a policy to even lower the gasoline price in mid January of 2009, specifically on 15 January 2009. The price of premium and solar gasoline decreased accordingly to be Rp 4,500/litre.

The ups and downs of domestic gasoline price indicated the need to start considering the use of market-based prices. Therefore, it is sensible for government to start applying the so-called market-based pricing for gasoline. Moreover, the public is starting to get used to accepting short-term price changes. In other words, this is the right time for the government to change its policy towards market-based gasoline pricing. Despite the proposal of a market-based gasoline pricing, it is important to bear in mind some negative effects of the policy that the government is currently implementing (i.e., to continuously decrease gasoline prices). From the last two experiences of price cuts, scarcity always follows the price decline. People were experiencing difficulties to get gasoline supply because gasoline stations were not receiving gasoline from official distributors. Lack of gasoline supply is only going to worsen the current economic condition of the country.

The scarcity of gasoline, to a large extent, happens because the entire stock was bought by industrial buyers. This is due to the price difference set by the government between the public and industrial buyers, where the industrial price is higher than the public gasoline price, creating the flow of gasoline stock from the public-use to industrial-use. Consequently, it is important for government to consider setting the same price for industrial and public consumption.

Overall, the current price changes in domestic gasoline have taught the public not to rely anymore on static prices like in the past. The public has started to base their price expectation on market condition. However, the government must closely monitor the price change policy, in order to avoid scarcity; otherwise, the policy will not be effective at all.

The State Budget and The Global Crisis

The House of Representatives approved the proposal by the government in giving flexibility for the 2009 state budget in responding to the potential global economic crisis. The parliament gave mandate to the government for some strategic plans that can be arranged to protect the Indonesian economy from the negative effects of the crisis.

At the moment, the government has made two types of strategic plans for maintaining the sustainability of the 2009 budget. The so-called defensive strategy consists of several work plans to re-evaluate the budget. The offensive strategy, meanwhile, consists of some coordinated plans to stimulate the economy in order to secure growth at the targeted level.

The defensive side particularly includes re-evaluating expenditure posts for non-priority and less important programs, reallocating the expenditure budget between central and local government, improving the definition and conditions for an economic emergency, and increasing the so-called fiscal-risk fund for backing up some plans should the economy deviate from the macroeconomic assumptions stated in the budget.

Meanwhile, the offensive or counter-cyclical strategy consists of, among others, a decrease in some tax rate, an implementation of zero percent export tax on CPO, starting immediately on 1 November 2008, and an allocation of Rp 10 trillion of tax subsidy to maintain economic stability. Moreover, government is designing a USD 5 billion standby financing from bilateral and multilateral cooperation, which aims to be achieved within a two- year period.

Some of the macroeconomic assumptions were changed. The targeted economic growth for 2009 was revised down from 6.2 to 6 percent and the targeted Rupiah-USD exchange rate is lowered from Rp 9,100 to 9,400 per 1 US dollar. These changes assumed some negative impacts from the current global financial crisis. One of the important channels to be considered is through a lowered expectation on Indonesian exports, and the potentially decreased volume of exports should give some pressure to the exchange rate. The government also changed the assumption of oil price, due to the large fall of world crude oil price. Earlier, government assumed oil price to be at the level of USD 100/barrel, but now, the assumption was set at a lower level of USD 80/barrel.

A growing debate issue is the likelihood of the decrease in subsidized gasoline prices, due to the lowering of global crude oil price. The House and the ministry of energy and mineral resources have been doing some assessment on the issue. However, the important issue here is that government must consider the psychological effect of the economy if the government eventually needs to increase again the fuel price, given the uncertainties surrounding the current movements of the world crude oil price.

Some of this year's infrastructure development projects are still on hold, although the projects have already been procured. This is due to careful considerations towards potential effects from the crisis wave. Government assures that the projects will be carried-out but may have to use other forms of financing such as the Public-Private Partnership (PPP) program. However, the government must also be aware that postponing the projects could also negatively affect the economy, and therefore, it must not hold the projects too long, since

it would give a negative long-term impact on the country's economic development.

Fiscal Stimulus

In the midst of domestic pressure to address global economic slowdown, the government launched fiscal stimulus package which is higher than what it was planned. The current package costs IDR71.3 trillion (USD 6.48 billion), or equal to 1.4% of GDP. It consists of tax saving on income tax, both individual and corporate, which accounts for IDR 43 trillion (USD 3.91 billion) or 0.8% of GDP. Tax saving is essentially part of the new tax law which sets higher level of maximum income exempted from income tax and cuts.

In addition, the package also waives value-added tax and import duties for business sector and targeted household. They comprise waived value-added tax for oil and gas exploration, and cooking oil accounted for IDR3.5 trillion (0.07%); waived import duties on raw material and capital goods by IDR 2.5 trillion (0.05 % of GDP); waived employee's income tax by Rp 6.5 trillion (0.12 percent of GDP) and waived tax on geothermal industry by IDR 0.8 trillion (0.02% of GDP).

As part of the package, the government increases several items of spending. The first is an increase in diesel fuel subsidy, to Rp 2.7 trillion (0.05% of GDP). Further, the package pledges to discount electricity rate of up to Rp 1.4 trillion (0.04 percent of GDP). To address the dire need for infrastructure, the government boosts spending on infrastructure project that accounted for Rp 10.2 trillion (0.2 percent of GDP). Equally important, the government also extends PNPM project by allocating budget around IDR 0.6 trillion (0.01% of GDP).

The allocated components clearly show the objectives of the package. The first is to promote domestic demand, particularly the consumption of low-middle class working family. This can be achieved by the waived employee income tax. Second, concern over high unemployment is expected to go down by infrastructure project, though only partially. The project, at the same time, also increases industry competitiveness. The latter objective might be reached in the

medium-term as the benefit of infrastructure is fully percolated by industries. But addressing unemployment by infrastructure project could become a bullet missing the target, particularly in the short-run. This should not be a surprise since the additional unemployment largely comes from manufacturing sector whose skills would not match the infrastructure project works. All in all, infrastructure project seems to address medium-run solution instead of short-run.

Furthermore, the poverty eradication program by the PNPM could be a sign of the government's commitment to help those who are vulnerable to economic shock. But, because of the general elections in the upcoming months, this program seems full of political nuances. Recently, the president SBY launched PNPM program and several infrastructure projects in Manokwari—capital city of West Papua. His intention is likely to be a political move as several polls show that he loses popularity among voters in this region.

Though some package components are deliberately good, others seem to distort the situation. First, a commitment to increase diesel fuel subsidy will not do much to encourage local industry. As a matter of fact, we have already learned in the past, that fuel subsidy often leads to fuel smuggling: leaving good intention policy ends up bad. Moreover, we do not see cooking oil subsidy as an urgent component. Cooking oil price follows international price of Crude Palm Oil (CPO). Amid global slowdown, we may expect that demand would be relatively stable and in turn keep CPO price at check. If so, there is no strong argument to continue cooking oil subsidy in the near future.